No. 73-1239

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MICHAEL R

In the Supreme Court of the United States

JANUARY TERM, 1974

MARKO DUROVIC,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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In the Supreme Court of the United States

JANUARY TERM, 1974

NO.

MARKO DUROVIC,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

To: The Honorable, The Chief Justice and Associate Justices of the Supreme Court of the United States:

The Petitioner, Marco Durovic, prays that a writ of certiorari issue to review certain portions of the judgment of the United States Court of Appeals for the Seventh Circuit, which portions affirmed the judgment of the Tax Court of the United States.[1]

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[1] Some portions of the judgment and decision were reversed outright, and other portions reversed and remanded for consideration in the light of the opinion (App. 1). Those portions are not part of this Petition, but they are reviewed briefly in the fact statement for a comprehensive presentation of the case.

OPINIONS OF THE COURTS BELOW

The Opinion of the Tax Court of the United States (App. 3) is reported under the same name at 54 T.C. 1364 (*Marko Durovic,* Petitioner v. *Commissioner of Internal Revenue,* Respondent). The Opinion of the United States Court of Appeals for the Seventh Circuit in *Marko Durovic,* Petitioner-Appellant v. *Commissoner of Internal Revenue,* Respondent-Appellee was entered on October 18, 1973, but is not yet officially reported. It is printed in the Appendix to this Petition. (App. 1) [2]

JURISDICTION

The judgment of the Court of Appeals affirming, in part, the decision of the Tax Court was entered on October 18, 1973, (one Judge dissenting). A timely Petition for Rehearing by this Petitioner as to the points affirmed, was denied on November 26, 1973, (One Judge Dissenting). (App. 2)

The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED FOR REVIEW

1. When a partnership return is timely filed, disclosing all gross income and no taxable income for either partner, does the Statute of Limitations begin to run for the assessment of alleged deficiencies in *individual* income taxes based thereon; or does the disallowance of certain deductions and expenses on the partnership return deprive the taxpayer of recourse to the Statute of Limitations on the basis that no individual tax return is filed.

---

[2] "App. . . ." denotes Appendix to this Petition.

2. (a) Where petitioner, a married man, has never had occasion to formally elect to file singly or on the basis of a joint return, does the Commissioner have the right, under Title 26, U.S.C. §6020(b)(1), to make the election and assess on the basis of a married person filing individually on no rationale other than to enhance the potential tax liability?

(b) Assuming arguendo such power in the Commissioner, may he assess on that basis solely to enhance the tax and simultaneously seize all property owned jointly by the taxpayer and his wife under the authority of a jeopardy assessment against the petitioner alone?

3. (a) Where petitioner, operating as a businessman with a profit motive, invests in the development of a drug intended for sale, but which was ordered by governmental direction to be destroyed as unmarketable, is the loss occasioned thereby a business loss governed by the carry-back and carry-over provisions of Title 26, U.S.C. §172 and is it not specifically excepted from capital loss treatment under Title 26 U.S.C. §1231?

(b) Further, when petitioner repaid a debt incurred for the development of the drug, does that qualify as a cost of development, or is it a gratuitous gesture with no tax consequences?

These are the two issues (point 3, (a) and (b)) which were timely appealed by petitioner and which the Court of Appeals failed to resolve.

4. (a) While petitioner, (his wife and partner-brother) were in the United States as non-immigrants, temporarily admitted for business purposes between 1949 and mid-1952, were they allowed to deduct their living expenses under the provisions of Title 26 U.S.C. §162, though their status was changed to immigrants in July 1952?

(b) Is the complete disallowance of the cost of maintenance of a non-profit organization (Krebiozen Research Foundation) for the purpose of securing statistics on the results and to advise on usage of the drug Krebiozen, an arbitrary deprivation of the deduction?

Statutory Provisions Involved

Title 26 U.S.C. §172 provides in pertinent part:

> (a) Deduction allowed.—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.
>
> (b) Net operating loss carrybacks and carryovers.—
>
> (1) Years to which loss may be carried.—
>
> (A) (i) Except as provided in clause (ii) and in subparagraph (D), a net operating loss for any taxable year ending after December 31, 1957, shall be a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss.
>
> • • •
>
> (B) Except as provided in subparagraphs (C) and (D), a net operating loss for any taxable year ending after December 31, 1955, shall be a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.
>
> • • •
>
> (2) Amount of carrybacks and carryovers.—Except as provided in subsections (i) and (j), the entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the "loss year") shall be carried to

the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. For purposes of the preceding sentence, the taxable income for any such prior taxable year shall be computed—

(A) with the modifications specified in subsection (d) other than paragraphs (1), (4), and (6) thereof; and

(B) by determining the amount of the net operating loss deduction—

(i) without regard to the net operating loss for the loss year or for any taxable year thereafter, and

* * *

and the taxable income so computed shall not be considered to be less than zero. For purposes of this paragraph, if a portion of the net operating loss for the loss year is attributable to a foreign expropriation loss to which paragraph (1) (D) applies, such portion shall be considered to be a separate net operating loss for such year to be applied after the other portion of such net operating loss.

* * *

(c) Net operating loss defined.—For purposes of this section, the term "net operating loss" means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

* * *

Title 26 U.S.C. §162 provides in pertinent part:

(a) In general.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

• • •

Title 26 U.S.C. §1231 provides in pertinent part:

(a) General rule.—If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, or conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For purposes of this subsection—

• • •

In the case of any property used in the trade or business and of any capital asset held for more than 6 months and held for the production of income, this subsection shall not apply to any loss, in respect of which the taxpayer is not compensated for by insurance in any amount, arising from fire, storm, shipwreck, or other casualty, or from theft.

• • •

Title 26 U.S.C. §6012 provides in pertinent part:

(a) General rule.—Returns with respect to income taxes under subtitle A shall be made by the following:

(1) Every individual having for the taxable year a gross income of $600 or more (except that any individual who has attained the age of 65 before the close of his taxable year shall be required to make a return only if he has for the taxable year a gross income of $1,200 or more);

(2) Every corporation subject to taxation under subtitle A;

(3) Every estate the gross income of which for the taxable year is $600 or more;

(4) Every trust having for the taxable year any taxable income, or having gross income of $600 or over, regardless of the amount of taxable income; and

(5) Every estate or trust of which any beneficiary is a nonresident alien;

except that subject to such conditions, limitations, and exceptions and under such regulations as may be prescribed by the Secretary or his delegate, nonresident alien individuals subject to the tax imposed by section 871 and foreign corporations subject to the tax imposed by section 881 may be exempted from the requirement of making returns under this section.

• • •

Title 26 U.S.C. §6013 provides:

(a) Joint returns.—A husband and wife may make a single return jointly of income taxes under subtitle A, even though one of the spouses has neither gross income nor deductions, except as provided below:

(1) no joint return shall be made if either the husband or wife at any time during the taxable year is a nonresident alien;

(2) no joint return shall be made if the husband and wife have different taxable years; except that if such taxable years begin on the same day and end on different days because of the death of either or both, then the joint return may be made with respect to the taxable year of each. The above exception shall not apply if the surviving spouse remarries before the close of his taxable year, nor if the taxable year of either spouse is a fractional part of a year under section 443(a)(1);

(3) in the case of death or one spouse or both spouses the joint return with respect to the decedent may be made only by his executor or administrator; except that in the case of the death of one spouse the joint return may be made by the surviving spouse with respect to both himself and the decedent if no return for the taxable year has been made by the decedent, no executor or administrator has been appointed, and no executor or administrator is appointed before the last day prescribed by law for filing the return of the surviving spouse. If an executor or administrator of the decedent is appointed after the making of the joint return by the surviving spouse, the executor or administrator may disaffirm such joint return by making, within 1 year after the last day prescribed by law for filing the return of the surviving spouse, a separate return for the taxable year of the decedent with respect to which

the joint return was made, in which case the return made by the survivor shall constitute his separate return.

(b) Joint return after filing separate return.—

(1) In general.—Except as provided in paragraph (2), if an individual has filed a separate return for a taxable year for which a joint return could have been made by him and his spouse under subsection (a) and the time prescribed by law for filing the return for such taxable year has expired, such individual and his spouse may nevertheless make a joint return for such taxable year. A joint return filed by the husband and wife under this subsection shall constitute the return of the husband and wife for such taxable year, and all payments, credits, refunds, or other repayments made or allowed with respect to the separate return of either spouse for such taxable year shall be taken into account in determining the extent to which the tax based upon the joint return has been paid. If a joint return is made under this subsection, any election (other than the election to file a separate return) made by either spouse in his separate return for such taxable year with respect to the treatment of any income, deduction, or credit of such spouse shall not be changed in the making of the joint return where such election would have been irrevocable if the joint return had not been made. If a joint return is made under this subsection after the death of either spouse, such return with respect to the decedent can be made only by his executor or administrator.

(2) Limitations for making of election.—The election provided for in paragraph (1) may not be made—

(A) unless there is paid in full at or before the time of the filing of the joint return the amount shown as tax upon such joint return; or

(B) after the expiration of 3 years from the last date prescribed by law for filing the return for such taxable year (determined without regard to any extension of time granted to either spouse); or

(C) after there has been mailed to either spouse, with respect to such taxable year, a notice of deficiency under section 6212, if the spouse, as to such notice, files a petition with the Tax Court of the United States within the time prescribed in section 6213; or

(D) after either spouse has commenced a suit in any court for the recovery of any part of the tax for such taxable year; or

(E) after either spouse has entered into a closing agreement under section 7121 with respect to such taxable year, or after any civil or criminal case arising against either spouse with respect to such taxable year has been compromised under section 7122.

(3) When return deemed filed.—

(A) Assessment and collection.—For purposes of section 6501 (relating to periods of limitations on assessment and collection), and for purposes of section 6651 (relating to delinquent returns), a joint return made under this subsection shall be deemed to have been filed—

(i) Where both spouses filed separate returns prior to making the joint return —on the date the last separate return was filed (but not earlier than the last date prescribed by law for filing the return of either spouse);

(ii) Where only one spouse filed a separate return prior to the making of the joint return, and the other spouse had less than $600 of gross income ($1,200 in case such spouse was 65 or over) for such taxable year—on the date of the filing of such separate return (but not earlier than the last date prescribed by law for the filing of such separate return); or

(iii) Where only one spouse filed a separate return prior to the making of the joint return, and the other spouse had gross income of $600 or more ($1,200 in case such spouse was 65 or over) for such taxable year—on the date of the filing of such joint return.

Title 26 U.S.C. §6020 provides:

(a) Preparation of return by Secretary.—If any person shall fail to make a return required by this title or by regulations prescribed thereunder, but shall consent to disclose all information necessary for the preparation thereof, then, and in that case, the Secretary or his delegate may prepare such return, which, being signed by such person, may be received by the Secretary or his delegate as the return of such person.

(b) Execution of return by Secretary.—

(1) Authority of Secretary to execute return.—If any person fails to make any return (other than a declaration of estimated tax required under section 6015 or 6016) required by any internal revenue law or regulation made thereunder at the time prescribed therefor, or makes, willfully or otherwise, a false or fraudulent return, the Secretary or his delegate shall make such return from his own knowledge and from such information as he can obtain through testimony or otherwise.

(2) Status of returns.—Any return so made and subscribed by the Secretary or his delegate shall be prima facie good and sufficient for all legal purposes.

Title 26 U.S.C. §6501 provides in pertinent part:

(a) General rule.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

(b) Time return deemed filed.—

(1) Early return.—For purposes of this section, a return of tax imposed by this title, except tax imposed by chapter 3, 21, or 24, filed before the last day prescribed by law or by regulations promulgated pursuant to law for the filing thereof, shall be considered as filed on such last day.

• • •

(3) Return executed by Secretary.—Notwithstanding the provisions of paragraph (2) of section 6020(b), the execution of a return by the Secretary or his delegate pursuant to the authority conferred by such section shall not start the running of the period of limitations on assessment and collection.

• • •

(c) Exceptions.—

(1) False return.—In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.

(2) Willful attempt to evade tax.—In case of a willful attempt in any manner to defeat or evade tax imposed by this title (other than tax imposed by subtitle A or B), the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment at any time.

(3) No return.—In the case of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * *

Title 26 U.S.C. § 6861 provides:

(a) Authority for making.—If the Secretary or his delegate believes that the assessment or collection of a deficiency, as defined in section 6211, will be jeopardized by delay, he shall, notwithstanding the provisions of section 6213(a), immediately assess such deficiency (together with all interest, additional amounts, and additions to the tax provided for by law), and notice and demand shall be made by the Secretary of his delegate for the payment thereof.

(b) Deficiency letters.—If the jeopardy assessment is made before any notice in respect of the tax to which the jeopardy assessment relates has been mailed under section 6212(a), then the Secretary or his delegate shall mail a notice under such subsection within 60 days after the making of the assessment.

(c) Amount assessable before decision of Tax Court.—The jeopardy assessment may be made in respect of a deficiency greater or less than that notice of which has been mailed to the taxpayer, despite the provisions of section 6212(c) prohibiting the determination of additional deficiencies, and whether or not the taxpayer has therefore filed a petition with the Tax Court. The Secretary or his delegate may, at any time before the decision of the Tax Court is

rendered, abate such assessment, or any unpaid portion thereof, to the extent that he believes the assessment to be excessive in amount. The Secretary or his delegate shall notify the Tax Court of the amount of such assessment, or abatement, if the petition is filed with the Tax Court before the making of the assessment or is subsequently filed, and the Tax Court shall have jurisdiction to redetermine the entire amount of the deficiency and of all amounts assessed at the same time in connection therewith.

(d) Amount assessable after decision of Tax Court.—If the jeopardy assessment is made after the decision of the Tax Court is rendered, such assessment may be made only in respect of the deficiency determined by the Tax Court in its decision.

(e) Expiration of right to assess.—A jeopardy assessment may not be made after the decision of the Tax Court has become final or after the taxpayer has filed a petition for review of the decision of the Tax Court.

(f) Collection of unpaid amounts.—When the petition has been filed with the Tax Court and when the amount which should have been assessed has been determined by a decision of the Tax Court which has become final, then any unpaid portion, the collection of which has been stayed by bond as provided in section 6863(b) shall be collected as part of the tax upon notice and demand from the Secretary or his delegate, and any remaining portion of the assessment shall be abated. If the amount already collected exceeds the amount determined as the amount which should have been assessed, such excess shall be credited or refunded to the taxpayer as provided in section 6402, without filing of claim therefor. If the amount determined as the amount which should have been assessed is greater than the amount actually assessed, then the difference shall be assessed and shall be collected as part of the tax upon notice and demand from the Secretary or his delegate.

(g) Abatement if jeopardy does not exist.—The Secretary or his delegate may abate the jeopardy assessment if he finds that jeopardy does not exist. Such abatement may not be made after a decision of the Tax Court in respect of the deficiency has been rendered, or if no petition is filed with the Tax Court, after the expiration of the period for filing such petition. The period of limitation on the making of assessments and levy or a proceeding in court for collection, in respect of any deficiency, shall be determined as if the jeopardy assessment so abated had not been made, except that the running of such period shall in any event be suspended for the period from the date of such jeopardy assessment until the expiration of the 10th day after the day on which such jeopardy assessment is abated.

STATEMENT OF THE CASE

The questions presented here are the result of litigation before the United States Tax Court and the Court of Appeals of the facts and circumstances whose genesis lay in the efforts of the petitioner, a lawyer, graduate of the University of Paris, and his brother, Dr. Stevan Durovic, a scientific researcher in the field of cancer. The petitioner's role in this endeavor was to help finance his brother's activities and the production and sale of marketable drugs. The research works of Dr. Durovic were directed to find a proper stimulant for the reticuloendothelial system which would produce a substance to control malignant growth which rested on a theory, then completely new, which provoked bitter controversy, but today, 30 years later, is scientifically accepted as the correct approach to solve the problems of malignant growth.

In his search for an active substance against malignant tumors, Dr. Durovic unexpectedly separated first a product called Kositerin, which appeared to be active against

hypertension, and which was acquired by petitioner for the purposes of sale at profit. Later on, following the same principle but using a different stimulant, Dr. Durovic obtained the product known as Krebiozen, which also was acquired by petitioner and sold by him and his brother through a partnership known as Duga Laboratories.

Both products had been produced in Argentina. Krebiozen was imported into this country in February, 1950.

For the years 1954 through 1958 partnership returns of income were filed on behalf of Duga Laboratories, all of which disclosed ordinary partnership losses. It was uncontested that said returns included *all* receipts of income from the distribution of Krebiozen and it is now uncontroverted that they did not include any fraudulent deductions. Petitioner did not timely file any individual returns of income, form 1040, for the years 1954 through 1958.

On October 28, 1964 the Respondent, Commissioner of Internal Revenue (hereinafter referred to as respondent), going ten years back, made jeopardy assessments against petitioner, Marko Durovic (hereinafter referred to as petitioner), for deficiencies in income tax and additions thereto (plus interest to that date), for the years 1954 through 1958 and in amounts as follows:

DEFICIENCIES

		ADDITIONS TO TAX		
		I.R.C., 1954		I.R.C., 1939
Year	Income Tax	Sec. 6653(b)	Sec. 6654(a)	Sec. 294(d)(1)(A)
1954	$27,353.08	$13,676.54		$2,520.17
1955	55,039.77	27,519.89	$1,537.58	———
1956	34,152.29	17,076.15	952.74	———
1957	83,875.51	41,937.76	2,344.54	———
1958	63,926.05	31,963.03	1,785.95	———

Pursuant to the jeopardy assessment, the respondent on November 9, 10 and 19, 1964, seized in currency from various sources in the amount of $81,937.16 and subsequently seized the following amounts realized from the sale of certain stocks on the stated dates: January 6, 1966, $13,916.41; January 9, 1967, $13,769.19; January 7, 1970, $10,635.40 all of which totalled $120,258.16.

The seized currency was applied by the respondent to the above deficiencies for the years and in amounts as follows:

DEFICIENCY	1954	1955
INCOME TAX	$27,353.08	$55,039.77
SECTION 6653 (b)	13,676.54	5,798.19
SECTION 294 (d) (1) (A)	2,520.17	———
INTEREST	15,649.71	———
ACCRUED INTEREST	220.70	———

Also on October 28, 1964, the Internal Revenue Service seized, under the jeopardy assessment, stock purchased by the petitioner on margin and kept by the brokerage firm of Norris and Kenly, the total value of which according to the quotations in the Wall Street Journal of October 28, 1964, was $665,378.25.

On November 10, 1964, the brokerage firm of Norris & Kenly, by order of the Internal Revenue Service to cover the margin and deliver the balance of the stock to them sold the following shares: 375 Colgate Palmolive Co.; 500 Curtiss Wright Corp., 520 Marin Marietta Corp.; 500 G.D. Searle & Co.; and 1000 Universal Match Co. from which was realized in excess of $80,000.00, reducing the value of the seized shares in their possession to $580,657.00.

In addition to seizing currency of $120,258.16 and stock, the Internal Revenue Service placed liens against the home

of the petitioner, Marko Durovic and his wife, at 875 Private Road in Winnetka, Illinois, and on industrial property owned by them at 100-104 South Desplaines Street in Chicago, Ill., which realty has a present value of no less than $300,000.00.

As of now, besides the cash the Internal Revenue Service is holding under jeopardy assessment 6,000 shares of Chrysler Corp., valued at the time of seizure at $60 per share, 1,000 shares of Sunshine Mining Company; 400 shares of Inspiration Copper Corp.; 100 shares of Bethlehem Steel Corp., together with liens on the house of the petitioner and his spouse at 875 Private Road, Winnetka, Illinois, and the building at 100-104 S. Des Plaines Street, Chicago, Illinois.

A statutory notice of deficiency was mailed to petitioner on December 28, 1964, covering the above years and deficiencies, and petitioner timely petitioned the United States Tax Court for a redetermination thereof. The case was docketed for trial and tried before the Tax Court commencing April 24, 1969 and ending May 7, 1969. Thereafter, briefs were filed by the parties and on June 24, 1970, the Tax Court rendered its opinion, 54 TC 1364, holding, insofar as is *pertinent* here, that:

I. The filing of forms 1065, U.S. Partnership Return of Income, for each of the years 1954 through 1958, did not toll the statute of limitations for assessment or collection of tax where the petitioner did not file individual returns of income, from 1040, for said years.

II. That the petitioner's failure to file individual returns or pay tax for the years 1954 through 1958 was not due to fraud with intent to evade tax and, accordingly, the respondent erred in asserting the additions to tax un-

der the provisions of section 6653 (b), Internal Revenue Code of 1954, the so-called fraud penalty, for each of the years 1954 through 1958.

III. That for the year 1954 the respondent erred in asserting the addition to tax under the provisions of section 294 (d) (1) (A), Internal Revenue Code of 1939, failure to file timely declaration of estimated tax, and that for the years 1955 through 1958, the addition to tax under section 6654 (a), underpayment of estimated tax, was properly asserted by respondent.

IV. That, in computing cost of goods sold for Krebiozen and Kositerin in terms of United States dollars, the rate of exchange of Argentine pesos into dollars should have been determined to be the "commercial rate of exchange" rather than the "official rate of exchange."

V. With respect to the product Krebiozen, the petitioner was an equal partner with his brother, Dr. Stevan Durovic, in a United States partnership, first known as Duga Biological Institute, later changed to Duga Laboratories, which was entitled to deduct as cost of goods sold the amount of 3,005,000 Argentine pesos (hereinafter referred to as pesos) paid by petitioner to one Juan Manuel Tanoira on January 26, 1950, for Tanoira's interest in the powder for 200,000 ampules of Krebiozen, produced as a result of Dr. Durovic's efforts:

(a) That the recognized cost of 3,005,000 pesos should be spread over 200,000 ampules of Krebiozen produced, rather than 136,097 ampules for which payments were solicited and made during the years, 1954 through 1958.

(b) That, of the expenditures incurred by the partnership in the United States, from October, 1949

through March 1954, in the amount of $130,713.48, only half ($52,693.69) was attributable to Krebiozen cost of goods sold. The balance was attributed, in part, to nondeductible research and experimental costs of Krebiozen and, in part, to personal living expenses of the Durovics.

(c) That the manufacturing and development cost of the drug known as Kositerin (a by-product obtained in the course of the search for a substance active against cancer (54 T.C. at 3061)), incurred by petitioner, was not attributable to the cost of Krebiozen.

VI. That the recognized cost of goods sold to petitioner for 72,200 ampules of the drug Kositerin, likewise developed by Dr. Durovic, was 792,600 pesos rather than the amount paid by him of 1,268,193 pesos:

(a) That when the 72,200 ampules were destroyed by the government of Argentina in 1956, petitioner incurred an ordinary loss in the amount of 792,600 instead of 1,268,193 pesos.

(b) That said loss is not subject to the two year carry back or the five year carry forward provisions of section 172, since the loss was not attributable to a trade or business.

(c) That as to the balance of the claimed Kositerin cost of goods;

(i) petitioner's payment in 1949 of 500,000 pesos to one Ada Bossard Von Martini represented the "gratuitous satisfaction of obligations incurred by Dr. Durovic during his early South American research."

VII. That the Commissioner's unilateral determination of deficiencies against petitioner on the basis of a married person filing separately and, thus, computed at the tax rates applicable to a single person for the years 1954 through 1958 precluded the petitioner's computing any tax deficiency ultimately found on the basis of rates applicable to a joint return for him and his wife.

Subsequent to the date of the Tax Court's Opinion the Petitioner filed a Motion To Reopen The Record For The Submission Of Further Evidence and a Motion For Reconsideration of Opinion. The Tax Court denied both motions by orders Dated April 7, 1971.

On April 20, 1972, the Tax Court entered its decision in accordance with and pursuant to its opinion, 54 TC 1364, (1970). On July 5, 1972, Notice of Appeal was timely filed in the Court of Appeals for the Seventh Circuit.

The Court of Appeals in a divided decision of October 18, 1973, affirmed in part, reversed in part and remanded in part for further consideration by the Tax Court in accordance with its opinion (App. 26).

The conflicting opinions of the majority and the dissenting Chief Judge, concerned vital issues of the running of the statute of limitations and applicability of joint vs. individual income tax rates both of which are the subject matter of this petition. Further, the Seventh Circuit Court failed to rule on the issue of whether the cost incurred in the purchase of the drug Kositerin properly included 500,000. - Argentine pesos paid by petitioner to one Ada Bossard von Martini and concomitantly, whether the total cost of Kositerin was a business loss to the petitioner, subject to the carryback and carryforward provisions of section 172, Internal Revenue Code of 1954, and the regulation thereunder.

The Evidence

The Tax Court made lengthy and complete findings of fact. Those findings are correct and objectively set forth the evidence at trial. They are adopted herein as a faithful statement of the evidence. Those findings are officially reported in 54 U.S. Tax Court Rp. 1364 to 1402 (1970).

Our contentions are that the Tax Court and, in certain important issues, the Seventh Circuit Court of Appeals made erroneous conclusions from that evidence. Where necessary to our Argument, the pertinent facts will be stated under the specific points.

REASONS FOR GRANTING THE WRIT

This Court should issue its Writ of Certiorari to the United States Court of Appeals in this cause on the following grounds:

I.

THE MAJORITY OPINION, REQUIRING THE FILING OF A SPECIFIC TYPE OR FORM OF RETURN IN ORDER THAT THE STATUTE OF LIMITATIONS BE TRIGGERED, CONFLICTS WITH THIS COURT'S DECISION IN GERMANTOWN TRUST CO. v. COMMISSIONER, 309 U.S. 304, AND MANY DECISIONS OF LOWER COURTS. FURTHER, IT HAS MISAPPLIED THIS COURT'S HOLDING IN COMMISSIONER v. LANE-WELLS, 321 U.S. 219 TO REACH A CONCLUSION NEITHER JUSTIFIED, NOR INTENDED, BY THAT DECISION.

Petitioner signed and filed for each calendar year 1954 through 1958 timely partnership returns with his partner-brother under the name Duga Laboratories. Each partnership return was prepared by a certified public accountant, Mr. Grauer, from partnership books and records maintained under Mr. Grauer's supervision which were complete in all respects. The partnership return for the year 1957 was examined during the year 1959 by Revenue Agent Bliss who specifically reviewed the method of amortization of costs. The District Director, Chicago, thereafter issued a "no change" report showing that the return was accepted as filed, (Ex. 27) and the return for the subsequent year 1958 is stamped "closed on survey" by the office of the District Director. (Joint Ex. 14-M).

Petitioner had no income or receipts in the years 1954, 1955, and 1956 except the gross income and gross receipts so reported on the Duga Laboratories information returns. For the years 1957 and 1958 petitioner and his wife earned interest from joint bank accounts in the amounts of $680.00 and $891.20 respectively, which is less that amount of the petitioner's and his wife's personal exemption. By reason of the family tax exemptions and deductions and the losses of the Duga Partnership, no individual tax return was required to be filed by petitioner for any of the years 1954 through 1958. Therefore, petitioner filed no personal returns (except the partnership information returns) until after the jeopardy assessment was made and the deficiency notice was issued to him. This was done in 1965.

In the present action the respondent, without reference to the prior 1959 examination and without ever again reviewing the partnership records, disallowed 100% or *in toto* the costs attributable to Krebiozen and deducted on each partnership return. Relying upon the fact that no individual returns on Form 1040 had been filed by petitioner for the years 1954 through 1958, respondent contended that the statute of limitations did not preclude his action in making these assessments because there is no limitation period controlling a wilful failure to file a personal return.

It is the petitioner's contention that, since the partnership returns of Duga Laboratories disclosed all of petitioner's gross income and gross receipts as well as substantially all other information relating thereto and to petitioner, the running of the statute of limitations prescribed by Section 6501 (a) of the Internal Revenue Code commenced no later than April 15th of the year following each of said years 1954 through 1958.

Since the Tax Court negated any contention of fraud (a determination not appealed by the respondent), and since there were no omissions from gross income of petitioner within the meaning of Title 26, U.S.C. §6501(e) in the partnership return, the petitioner contends the assessment was outlawed by the limitations statute. However, the Court below in a 2-1 decision determined that the statute was not applicable for failure to file an individual return.

Section 6501 (a) provides, that the amount of any tax must be assessed or a proceeding in court for collection instituted within three years after the return is filed. Neither the statute nor the Commissioner's regulations thereunder define the meaning of the term "return". As a general proposition a "return" is a good faith, honest statement of the specific items of a tax payer's income, deductions and credits. *Estate of Henry Wilson et al.* v. *Commissioner of Internal Revenue,* 2 T.C. 1059 (1943); *John W. Houston* v. *Commissioner,* 38 T.C. 486 (1962). The "return" need not be perfectly accurate and complete in all particulars. It is sufficient if it is substantially in compliance with statutory requirements for a return. *Zellerbach Paper Company* v. *Helvering,* 293 U.S. 172 (1934), 79 L.Ed. 264; *Consolidated Apparel Co.,* 17 TC 1570 (1952), aff'd and rev'd, in part, on other grounds, (7 Cir.) 207 F.2d 580; *Germantown Trust Company* v. *Commissioner,* 309 U.S. 304 (1940). Further, in deciding the availability of the six year limitations period section 6501(e), it has been held that a partnership return must be considered with filed individual returns in determining whether a "return" has been filed, *Wilbur W. Myers and Millicent Myers* v. *United States,* 72-2 USTC 9669; *Jack Rose* v. *Commissioner,* (1955) 24 TC 755; and *Nadine J. Davenport* v. *Commissioner,* (1967) 48 TC 921. The data

required is that which is necessary to enable the Internal Revenue to compute and assess the tax. *John W. Houston* v. *Commissioner,* 38 TC 486; *Bean* v. *Hamilton,* 5 Cir., 288 F.2d 9, *O'Sullivan Rubber Company, Inc.* v. *Commissioner,* 2 Cir., 120 F.2d 845. The statute should start running when the Internal Revenue has substantially complete information upon which to compute and determine tax, *Joy C. Vogel* v. *Commissioner,* TC Memo 1962-251. The fact that the exact form prescribed by the Commissioner is not used should not prevent the running of the statute of limitations, if the return meets the statutory requirements. Accordingly, various Courts have held that the filing even of a wrong form in certain situations did not necessarily preclude the running of the three year statute of limitations. This was the result reached in *California Thoroughbred Breeders Association* v. *Commissioner,* (1966) 47 TC 335 (filing of form 990 rather than 990-T unrelated business income form, commences the running of the limitations period, if filed in good faith and apprises the Service of the potential existence of such income); *Germantown Trust Co. Trustee* v. *Commissioner,* 309 U.S. 304 (filing of fiduciary return, Form 1041, rather than Form 1120 corporate return, commenced running of limitations period). (Rev. Rule 69-247, 1969-2 C B p. 30).

We submit it is a sacrifice of substance to form to hold, as has been held here by the majority in the Court of Appeal's opinion, that the right of the Commissioner to prescribe forms can be regarded as resulting in a nullification for all informational purposes of a sworn and complete statement of income. Reasonable doubts should be resolved in favor of taxpayers. *Hartford, Connecticut Trust Fund Co.* v. *Eaton,* 2 Cir., 34 F.2d 128 (filing information return Form 1041 rather than 1040 commenced

running of limitations); *Benderoff* v. *United States*, 6 Cir., 398 F.2d 132 (Subchapter "S" corporate information return, Form 1120 S, attached to taxpayer's individual return sufficient to start limitations period.) To the same effect, see *Myers* v. *United States*, 72-2 TC 9669. The rationale underlying these cases is a good faith and reasonable attempt to substantially comply with the tax laws and that any "return" upon which such information is reflected, is sufficient to provide clues to controverted items. When there is such compliance the Internal Revenue Service is at no disadvantage. None was demonstrated in this case.

The partnership returns filed on behalf of Duga Laboratories for the years 1954 through 1958 are comprehensive and elaborate. They reveal, *inter alia*, all items of gross receipts, deductions, credits, payments to and contributions by each partner, each partner's capital accounts and distributive share of income and credits, address of partnership and location of partnership books and records, capital gains and losses and the name and address of the preparer of the return. The partnership returns were verified under penalties of perjury, by one of the partners as well as the preparer of the returns and were so verified by this petitioner. They are similar, in practically all pertinent respects, to a Form 1040, Schedule D, reflecting gross receipts and deductions of a sole proprietorship.

What was presented to the Government on the partnership returns was a complete and accurate accounting of substantially all information necessary to a determination and computation of any tax due from petitioner.

It should be noted that in 1959 the partnership return for 1957 and books and records of Duga Laboratories were audited by the Service with the cooperation of the petitioner, his wife and his accountant and a "no change"

letter issued. It can fairly be assumed that at least at that early date the Government was aware that Petitioner had no occasion to file individual returns of income. Obviously, his marital status was known.

The majority opinion of the Seventh Circuit Court of Appeals overlooks, in this lengthy record, what information is to be reflected on an individual return of income, Form 1040. The majority incorrectly held, (App. 4, fn. 1) that "* * * The taxpayer had, in each year (1954 through 1958), a gross income of $600 or more. * * *" This statement is not factual. The only income or receipts (gross and net) he and his wife jointly earned in these years was interest income of $680.00 and $891.28 in the years 1957 and 1958, respectively.[3] The partnership, Duga Laboratories, reported the gross receipts set forth in the opinions (App. 4) as "Received from Krebiozen," not this taxpayer. Only Duga Laboratories, under any interpretation of the Internal Revenue Code, was responsible and required to report on the partnership information return of income, Form 1065, all receipts from the distribution of Krebiozen and all costs, deductions or credits applicable thereto. When this obligation was honestly and accurately fulfilled by the partnership, the Commissioner, beyond argument, was armed with sufficient information upon which to conduct a thorough audit, if he so chose, and determine any

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[3] Except for these two modest items, the whole of the assessment here derived directly from the partnership information return. Coupled with the 80% rule (App. 6), there is no way the Respondent can conscientiously contend a want of necessary information.

Even these modest items were joint income of Petitioner and his wife, a fact that militates against the individual tax treatment given Petitioner and discussed under II.

liability of any partner for any tax that might flow therefrom. This, in fact, the Commissioner did! Nowhere in this voluminous record is there any evidence or a contention that the partnership *omitted* receipts, and it has now been established, there was *no* fraud with respect to any item of receipts on deductions shown on the partnership return.

The fallacy of the majority's position is that they are equating the liability to report gross income or receipts of the partnership with petitioner's liability to report and account for gross income received by him. This taxpayer has no duty, statutory or otherwise, to report on an individual return, Form 1040, the gross receipts or income derived by or deductions or other credits attributable to the partnership. For tax reporting purposes the partnership is a distinct, separate entity.

Conceding that the partnership returns reported "* * * all of the appellant's actual income for 1954-56 and all income with the exception of dividend [sic] earnings of $681.00 and $891.28 for 1957 and 1958 * * *" the majority (App. 6) concludes that such "happenstance" was not sufficient to commence the running of the statute of limitations, relying on *Commissioner* v. *Lane-Wells,* 321 U.S. 219 (1944). However, the majority (App. 7-8) specifically recognizes that the *"sine qua non"* expressed in *Lane-Wells* is that the return show the facts on which liability can be predicated. With this we are in full agreement. *Germantown Trust Co.* v. *Commissioner,* 309 U.S. 304 (1940). This *sine qua non* is precisely the "happenstance" relied upon by the Court in *Lane-Wells, Germantown* and the other cases dealing with this issue, in holding that the running of the statute of limitations depends upon what information is shown on the "return"

in question. As succinctly defined in the dissent, to qualify as a "return" with reference to a particular tax, a completed tax form must disclose the facts on which liability can be predicated. (App. 34).

Insofar as the years 1954 through 1956 are concerned, there is not one item of income or receipts omitted from the partnership returns for those years that could conceivably affect petitioner's gross income. It is true that petitioner's right to claim and deduct his personal and dependency exemptions as well as his itemized or standard deductions or other credits were not reflected on these partnership returns but, as the dissenting Judge pragmatically pointed out (App. 32), the Commissioner cares not a whit about such deductions and, as we note, at least in this case, the Commissioner's only interest was to assess and collect the highest tax possible. (Otherwise, how does one explain the Commissioner's failure to compute petitioner's tax liability on the reduced joint income tax rates?)

With respect to the majority's reliance on section 6501 (c) (3) as giving the Commissioner unlimited time to assess or collect additional tax, it is petitioner's position that said section does not come into play except when there is "no return" filed. As the dissent notes, "The central problem of this case lies in determining the meaning of the word "return" as used in the statute." (App. 29). Neither the statute nor the majority resolves this central problem.

The dissent holds, as petitioner has argued, that the conclusion reached in *Lane-Wells* is clearly distinguishable from the conclusion and facts in this case, in that a crucial question to be answered on the corporate return

in *Lane-Wells* was whether the corporation was a personal holding company subject to an additional tax, which question was answered in the negative. This was the central issue in *Lane-Wells* to which the Supreme Court addressed itself, holding that:

* * *

> "But it seems admitted that the returns did not show the facts on which [personal holding company] liability would be predicated. *Such liability was expressly denied by the return* and to obtain data on which corporations subject to the tax could be identified and assessed was the very purpose of requiring a separate return addressed to that liability." (emphasis added) 321 U.S. 219, 223.

See also *Colony, Inc.* v. *Commissioner of Internal Revenue,* 357 U.S. 28.

Lane-Wells did not hold that two separate returns must be filed in every situation; it only held that if the "return" as filed did not disclose all information from which the required tax could be computed, then it was not a "return" required by law and was insufficient to trigger the running of the limitation period. The difference between *Lane-Wells* and this case is that *all* information relative to gross receipts and deductions as well as the names and addresses of the partners were disclosed on the partnership returns. The rationale underlying the cases cited by the parties and the Court is that if there is an omission of an item on the face of the "return" the Commissioner is at a disadvantage; however, when the understatement of tax is a direct result of an error in reporting an item disclosed on the face of the return or of a disagreement between the Commissioner and the taxpayer as to the treatment of items reported on "returns," which was precisely the situation here then the Commissioner is at no disadvantage and the ordinary limitations period should

commence to run as a result of the "return" actually filed. See section 6501 (e) (1) (A) (ii) in limiting the application of section 6501 (e) (1) (A) (i), six year limitation period.

Insofar as interest income earned in the years 1957 and 1958 is concerned, it is conceded that, in isolation, there were sufficient amounts requiring the filing of individual returns for those years (but not joint returns, and the interest was jointly earned); however, considered together with the information reflected on the partnership returns, the Commissioner was sufficiently apprised of and armed with information from which it could be determined whether petitioner was liable to file individual returns and pay income tax. With nothing more than the interest income, petitioner's deductions for personal and dependency exemptions and standard or itemized deductions would have resulted in no taxable income due for the years 1957 and 1958. Further, the dissent notes (App. 30) that "* * *; the Government must address its argument to the wisdom of Congress, which has to date provided that the Commissioner has three years at most for an assessment when he is made aware of eighty percent, not all, of the gross income of a taxpayer? It is of no significance then, that the partnership returns filed by Durovic did not disclose "his income from other sources."

It is submitted that the filing of partnership returns for the years 1954 through 1958 was a good faith, accurate reflection of all substantial information necessary to compute and determine whether petitioner owed any tax to the Government and triggered the running of the statute of limitations under Section 6501(a). Accordingly, the period for assessment or collection of tax for each of the years 1954 through 1958 expired prior to the issuance of the notice of deficiency and the jeopardy assessment.

II.

THE INTERNAL REVENUE CODE NOWHERE EXPRESSLY GIVES THE COMMISSIONER THE RIGHT TO ELECT THE CAPACITY IN WHICH A TAXPAYER SHALL FILE. THIS CASE IMPARTS THAT RIGHT, AND AUTHORIZES A GROSSLY ENHANCED TAX OBLIGATION, AS A POWER INHERENT IN TITLE 26 U.S.C. §6020(b)(1). THIS COURT SHOULD ISSUE ITS WRIT FOR THE PURPOSE OF INTERPRETING THIS STATUTE, AND DETERMINING WHETHER AN ADVERSE UNILATERAL ELECTION BY THE RESPONDENT SATISFIES THE DUE PROCESS CLAUSE OF THE FIFTH AMENDMENT, AND THE EQUAL PROTECTION GUARANTEES INHERENT THEREIN, AND MORE PARTICULARLY, WHETHER THE STATUTE CAN BE INTERPRETED TO ALLOW INDIVIDUAL ASSESSMENT, AND AT THE SAME TIME, SEIZURE OF ALL JOINT PROPERTY ON THE BASIS OF THE INDIVIDUAL ASSESSMENT.

The partnership information returns filed in the name Duga Laboratories for the years 1954 through 1958 reflected ordinary losses. Neither petitioner nor his wife had any other source of income for the years 1954 through 1956. In the years 1957 and 1958, their only source of income other than the partnership derived from interest from their Exchange National Bank of Chicago savings accounts in the respective amounts of $680.00 and $891.28.[4] Based on the advice of counsel, Petitioner did not file returns of income for any of the years 1954 through 1958.

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[4] Another anomoly in this case is that these were joint bank accounts of the Petitioner and his wife. These were seized pursuant to the jeopardy. Yet the feasibility of taxing on the basis of joint filing, was not considered.

On October 28, 1964, ten years later, under color of section 6861 (a), a jeopardy assessment was made against petitioner alone for the years in issue, and the Internal Revenue Service computed deficiencies in income tax for each said years based on tax rates, credits and deductions applicable to married persons filing separate returns. A statutory notice of deficiency was issued on December 28, 1964 which adopted, without change, the assessed jeopardy deficiency of October 28, 1964.

The respondent stated the situation clearly in argument below: "On October 28, 1964, the Internal Revenue Service made a jeopardy assessment against taxpayer in the amount of $519,063.05 and levied on all the assets owned by taxpayer *and his wife.*"

This clearly shows by their own admission that the Internal Revenue Service knew and seized joint property of petitioner and his wife, but refused to recognize the right to file and compute taxes on the basis of joint return and joint tax rates.

Thereafter, petitioner and his wife Olga, prepared joint income tax returns for the years 1954 through 1958, each of which reflected the distributive share of partnership losses shown on the timely filed Duga Laboratories partnership and the 1957 and 1958 joint returns reported interest income from the Exchange National Bank savings accounts. These joint returns for said years were then filed with the District Director, Chicago, Illinois on March 10, 1965.

It is the petitioner's contention that the Internal Revenue Code of 1954, confers upon him the right to file a joint return. Section 6013 (a). There is no provision in the Code giving the Internal Revenue Service the right to inexorably "elect" to file returns, joint or separate, on behalf of taxpayers. Except within narrowly prescribed

circumstances, the Internal Revenue is precluded from taking any action against taxpayers absent compliance with well-defined statutory as well as administrative audit and investigate procedures. Neither sections 6851 or 6861, or 6020[5] authorize the Internal Revenue to irrevo-

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[5] Secs. 6851 and 6861 provide for Termination of taxable year when income tax is in jeopardy or when assessment or collection will be jeopardized by delay.

Section 6020 (b) (1) authorizes the Secretary or his delegate to make a return, if a taxpayer fails to do so on time, from his own knowledge, and information he can obtain through testimony or otherwise. Section 6020 (b) (2) provides that such return made and subscribed by the Secretary or his delegate shall be *prima facie* good and sufficient for all legal purposes. There is no evidence in the record that the Internal Revenue Service acted pursuant to section 6020 (b) (1) or that, in fact, returns were actually prepared. It appears that the computation of deficiencies were purely arithmetical and bookkeeping procedures. The Respondent never introduced into evidence "returns" prepared by the Secretary or his delegate.

Assuming section 6020 (b) (1) was properly utilized by Respondent, section 6020 (b) (2) accords it only *prima facie* correctness. The filing of joint returns by Petitioner should be sufficient, of itself, to remove the *prima facie* correctness of Respondent's determination, at least with respect to computing taxes on the basis of joint tax rates, credits and deductions. Also, when not based upon any factual information, *prima facie* correctness should not be accorded to the "returns" prepared by the Government. *Rinieri* v. *Scanlon*, 254 F. Supp. 469 (1966). The record here supports the conclusion that the Government's one hundred percent disallowance of all partnership deductions were arbitrary and unconscionable and not based on any factual information but was calculated by the Government in order to justify seizure of all Petitioner's, and his wife's, assets thereby depriving him of the financial resources to defend himself in the indictment returned the same day the jeopardy assessment was made, October 28, 1964. The defendant (here petitioner) was acquitted of all charges.

We consider it significant that the amount of the bond set $500,000, and the jeopardy assessment here are in approximately the same amount.

cably "elect", on behalf of taxpayers, whether to compute taxes based on joint or separate tax rates.

The predecessor of the Tax Court, the Board of Tax Appeals, in a converse situation, *Joseph Calafato and Lena Calafato* v. *C.I.R.*, 42 BTA 887 (1944), upheld the Internal Revenue Service's Determination of tax liabilities calculated on *joint tax rates,* based on an exhaustive investigation of the taxpayers' financial affairs and held:

> "* * If a husband or wife, in a proceeding before us, establishes a basis for making an allocation of income * * * or an equitable basis for apportioning it * * * he or she will be relieved of the portion of the tax allocable to the income of the other * * *. But petitioners made no effort to furnish us with the information, being content to rely merely upon a showing that separate bank accounts were maintained by them. In this posture of the proceeding we feel that we have no alternative but to approve the Commissioner's determination for failure of the petitioners to sustain their burden of proof."

See also *Roy Dixon and Louise Dixon* v. *C.I.R.*, 28 T.C. 338 (1957), approving Internal Revenue Service determination of tax based on *joint tax rates* after finding that a thorough investigation was made of Taxpayers' financial affairs and that a return required by law was not properly filed by taxpayers.

It is interesting to note that in these two cited cases the Internal Revenue Service saw fit to determine the taxpayers' tax liabilities based on joint rates, but here, determines on the basis of individual rates. *The original difference in liability to the petitioner between joint vs. individual rates was $114,000.*

The petitioner overwhelmingly established in the Tax Court below that he and his wife were entitled to file joint returns for the years 1954 through 1958 and the "returns" prepared by the government (if any were) were not based on any factual information and, accordingly, were not even *prima facie* correct. To the contrary, the basis of the government's computation of partnership income and the calculation of tax liabilities in excess of $500,000.00 were patently arbitrary, excessive and unconscionable.

Subsequent events after being acquitted of all criminal charges on the indictment hereinabove referred to and the Tax Court proceedings proved the "Jeopardy" to be totally unfounded and unwarranted.

In its opinion the Tax Court held that:

> "In the instant case, petitioner and his wife did not file joint returns for the years 1954 through 1958 until March 10, 1965. Clearly, therefore, had they originally filed individual returns for these years, their election in 1965 to file joint returns would have been untimely. We see no reason why the same rule should not obtain where, as here, no returns originally filed. However, we need not premise our decision on this fact alone since, in our estimation, the administrative consideration which accompany a system such as ours, where taxation is based upon voluntary disclosure, demand that where, as the result of a failure to file a return, the Commissioner has been required to make an election for taxpayers * * * that election may not thereafter be altered. *Spanos* v. *United States*, 212 F. Supp. 861, 864 (D. Md. 1963), reversed in part by 323 F.2d 108 (C.A. 4, 1963), but affirmed as to matters relevant to the language quoted. See also cases discussed therein. Accordingly, we believe this issue must be decided in favor of respondent." 54 T.C. at 3076.

With respect to the first portion of the Tax Court's findings applying the rule that, had petitioners filed timely individual returns, the respondent would have been barred by Section 6013 (b) (2) (B) from electing to file joint returns, we submit that section 6013 has never been construed to bar an initial election to file a joint return made *after* the due date of a return. See *Spanos* v. *United States,* (1963) 212 F.Supp. 861 (fn.3) and *Spanos* v. *United States,* 323 F.2d 108 (1963) aff'g, in part, rev'g in part, 212 F. Supp. 861. Also the Tax Court's reasoning begs the question. The fact of the matter is petitioner and his wife did not file individual returns originally, therefore, there is no statute of limitations to commence the running of the time in which to make an election under any applicable provision of the Internal Revenue Code of 1954.

With respect to the second portion of the Tax Court's finding that "• • • the administrative consideration which accompany a system such as ours, where taxation is based upon voluntary disclosure, demand that where, 'as the result of a failure to file a return, the Commissioner has been required to make an election for the taxpayers • • • that election may not thereafter be altered.' " citing the *Spanos* case. The *Spanos* case does not stand for such a rule, nor could it since the facts presented no such case or controversy. There, prior to the death of Mrs. Spanos' husband, they filed a 1955 *joint return of income.* The return was two and one-half months late. The tax due thereon was not paid. Subsequently, the husband died. The Service assessed the joint tax shown on the return plus an addition for fraud and interest. Mrs. Spanos brought suit disavowing the joint return on the ground that since it was filed late it was a nullity. The Court, in disposing of Mrs. Spanos' contention held:

> "* * * the mere late filing of a return does not nullify it, (citing cases) * * * the taxpayer and her husband elected to file a joint return on July 2, 1956, and that return was accepted and acted upon by the Commissioner. Equitable considerations as well as the administrative problems of the converse result, indicate that that election is binding on her and may not now be modified."

On appeal the lower Court's decision upholding the validity of the Spanos' 1956 joint return was affirmed. *Spanos* v. *U.S.*, 323 F.2d 108.

There appears to be no legal basis for not granting to petitioner the tax advantage predicated on a joint return.

II-A

The majority opinion in concluding that petitioner was not entitled to file joint returns and to compute taxes based on joint rates relied on section 6013 (b) (2) (B), Internal Revenue Code of 1954 and *Spanos* v. *U.S.*, 212 F. Supp. 861 (D. Md. 1963).

But, as the dissent points out so clearly, section 6013 (b) (2) (B) is specifically limited in application to cases falling within subsection 6013 (b) (1). As stated by the dissent (App. 40) "* * * the legislative history of section 6013 gives no hint of a Congressional purpose to encourage voluntary disclosure by section 6013, and the conclusion becomes inescapable that subsection 6013 (b) (2) must be limited, as it states on its face, to situations where a return which elects individual filing status has been made." The statute is silent concerning the filing of joint returns where no returns were initially filed. However, Revenue Ruling 72-539, I.R. B. 1972-45, 13, holds that "* * * even though the election to change from a separate

return to a joint return is barred after the expiration of three years from the last date prescribed for filing a return, *this does not preclude an election to file a joint return for the first time.*" (Emphasis added). Thus, the silence has been interpreted by the ruling contrary to the majority opinion, and contrary to the Commissioner's urgings.

Reliance on *Spanos* by the majority is misplaced. The majority (App. 11-12) specifically held that "However . . . 'as the result of failure to file a return, the Commissioner has been required to make an election for the taxpayers . . . that election may not thereafter be altered.' Spanos v. United States, * * *." It is first noted that Mrs. Spanos and her husband filed an untimely return, which she attempted to disavow after his death contending that since it was untimely it was a nullity. The District Court upheld the validity of the untimely filed joint return, which was affirmed by the Court of Appeals, Fourth Circuit, holding that untimely filing does not nullify a return accepted and acted upon by the Commissioner. The *Spanos* factual situation is a far cry from the facts and circumstances confronting this Court. The sole issue presented and decided in *Spanos* lends no support to the majority's view.

Further, if the *Spanos* factual situation can be stretched to concern this case, then the majority view cannot withstand the dissenting judge's analysis of the under-pinnings of *Spanos*. The dissent points out that the rule espoused in *Spanos* is based on equitable considerations other than statutory construction and, of the three cases relied on in *Spanos* in support of the ruling (*Grant* v. *Rose,* 24F-115 (N. D. Ga. 1928) aff'd *Rose* v. *Grant,* 39 F.2d 340 (C.C.A. 5th, 1930), *Grobart* v. *Commissioner,* 20 T.C.M. 629 (1961) and *Mundy* v. *Commissioner,* 14 T.C.M. 1067 (1955)), only *Grobart* and *Mundy* were apposite to this case. The rea-

soning in *Mundy* was predicated upon pre-1954 Code limitations which were removed by the passage of section 6013 (b) "Whatever the validity of this statutory interpretation under the Internal Revenue Code of 1939, Congress has since deprived it of force by passing subsection 6013 (b). It is no longer true that an election to file jointly 'must be exercised by . . . taxpayers at the time the return is filed. * * *'" (App. 42).

In *Grobart,* the taxpayer, a married individual, after petitioning the Tax Court for a redetermination of deficiencies in tax based on individual tax rates, filed a joint return with his wife and contended that the tax should be computed on the basis of joint rates. The tax years at issue in *Grobart,* were 1944 through 1946 and were, like *Mundy,* governed by pre-1954 Code limitations as to when an election to file jointly or singly, or vice-versa, could be made. Citing language from *Grant* v. *Rose,* the Tax Court held that section 51, Internal Revenue Code of 1939, precluded the filing of joint returns *after* the due date for filing had expired. Since it has been so succinctly dealt with, we feel the dissent is worth repeating:

> "As I have already pointed out in connection with Mundy, the passage of subsection 6013(b) has removed the central premise of this argument. Congress has said, in effect, that the 'strong administrative reasons for not permitting the upsetting of the whole basis of calculation' must give way to a taxpayer's freedom of choice, so long as the taxpayer makes his final election of joint rates within three years of the last legal date for filing his return. That the Commissioner, rather than the taxpayer, has made an initial election of individual tax rates should not, without more, prevent the taxpayer from choosing to be taxed at joint rates; from the Commissioner's point of view, his election is indistinguishable from one which the taxpayer might originally have made for

himself. Should the election of the Commissioner stand three years unchallenged, a different case would be presented. Within that three years, however, Congress has suggested that the equities lie with the taxpayer. It seems, furthermore, highly inequitable to accept an argument by the Commissioner directed to his administrative burden of recomputation when, had he simply determined the amount of income upon which tax was due and let the taxpayer make an election of filing status, the burden could have been avoided. In truth, the Commissioner is making an unwanted and expensive election for a taxpayer and thereafter employing that election to assert that its modification would be burdensome to his agency.

"The Durovics filed joint income tax returns for the years at issue less than three months after having received a deficiency notice. I doubt that even the Grobart court—which had faced a two year acceptance by a taxpayer of a Commissioner's election of individual tax rates—would have disallowed those returns. In any event, Grobart, and hence Spanos, are based on old law, the amendment of which has left them little vitality." (App. 44).

III.

LOSSES SUSTAINED BY THE DESTRUCTION OF INVENTORY, DEVELOPED AND HELD PRIMARILY FOR SALE ARE EXCLUDED EXPRESSLY FROM CAPITAL LOSS TREATMENT UNDER TITLE 26 U.S.C. §1231(b)(1)(A) AND (B), AND THE DECISION OF THE TAX COURT IS DIRECTLY CONTRARY TO THE DIRECTION OF THE STATUTE, THUS DEPRIVING THE PETITIONER OF THE RELIEF PROVISIONS OF TITLE 26, U.S.C. §172.

This is the issue the Court of Appeals failed to resolve. The following is petitioner's argument presented to said Court.

A. The petitioner's argument hereunder is that petitioner is entitled to deduct costs of Kositerin as a business loss when the Kositerin ampules he purchased were ordered destroyed in Argentina in 1956, by the Public Health of that country.

The Tax Court held that Kositerin cost of 1,268,193 pesos was not includible as part of the cost of Krebiozen, basically because the 72,200 ampules of Kositerin were never contributed to or used in the activities of Duga Illinois. The Court did recognize investments by petitioner in his Duga Laboratory in Argentina in the amounts of 255,100 pesos and 537,500 pesos in a total amount of 792,600 pesos.

The Tax Court's holding recognized that petitioner was in the business of producing and marketing drugs for profit, and that he did incur a loss upon the destruction, due to spoilage, of 72,200 ampules of Kositerin by the order of the Argentine government in 1956. The loss was limited by the Tax Court to 792,160 pesos under Section 1231 but was not subject to the carry-back or carry-forward provisions of Section 172, since it was "not attributable to a trade or business."

It is petitioner's contention that such amount should include also his payment to Mrs. von Martini of 500,000 pesos (totaling 1,292,160), or in the alternative, be based upon the Argentine production cost of 1,268,193 pesos determined after thorough investigation by the Ministry of Public Health of Argentina in 1949. Whichever amount is taken it should be subject to the two year carry-back and five year carry-forward provisions of Section 172.

Petitioner was, and is a businessman and investor. The Tax Court recognized that he had a profit motive with respect to Krebiozen and Kositerin. (54 T.C. at 3073).

It appears that the Tax Court's denial of the application of Section 172's provisions to the suffered loss was bottomed upon the fact that the loss was not attributable to a trade or business which was contrary to his position relative to Kositerin and the Duga Laboratory.

The Tax Court found the following facts:

Petitioner was not in the research business. He had possession of 72,200 ampules of Kositerin and after he acquired Duga Laboratory, he took steps in Argentina to bring them to market. Acting through Dr. Galmerini, the laboratory's technical director, a license to sell at prices to be set by the Argentine government was obtained. The price structure required supporting data from Duga Laboratory. Their efforts to comply with requirements set by Argentina continued from January 1950 through part of 1954. The Tax Court found and the evidence discloses the following:

(a) He was, at the time of the destruction of Kositerin, owner of the Laboratory for production of medical products, one in Buenos Aires and another in Chicago in Partnership with his brother. (Ex. 43; 54 T.C. at 3061).

(b) The Laboratory Duga in Buenos Aires was owned by the petitioner and licensed to produce biological products. (Ex. 43).

(c) Petitioner was selling Krebiozen in United States and Uruguay, where the product was licensed for sale, and he tried to sell Kositerin in Argentina. (Tr. 662, 665, 666, 870, 871).

(d) Kositerin was destroyed by order of the Ministry of Public Health of Argentina. The drug was tested and the laboratory inspected, each year. (Exs. 40, 41, 44, 45,

46, 47, and 57; Tr. 500, 501, 502, 505, 506, 507, 508, 513, 514, 541, 542, 543, 544). The drug was safe and effective until 1956, when the destruction was ordered.

(e) The Argentine Laboratory was maintained until after February, 1956, when the destruction of the ampules due to spoilage took place in Argentina, which petitioner witnessed. (Tr. 871). The Tax Court held that these facts "* * * all evidence the fact that petitioner held the ampules for the production of income until the time they were destroyed.* * *" (54 T.C. at p. 3073).

So finding and so holding, it is inconceivable and inconsistent that the Tax Court can then conclude the loss upon destruction was not a loss attributable to a trade or business.

The petitioner is contending for a loss deduction from Kositerin's destruction under the provisions of Section 165 (a) and (c) (1) permitting deductions of any loss during the taxable year limited, in the case of individuals, to losses incurred in a trade or business. He has invested substantial funds in the production of Kositerin and, as the Tax Court held, his motive for so doing was profit. See *Mercer* v. *Commissioner,* 9 Cir., 376 F.2d 708 and *Whitman* v. *U.S.,* 248 F. Supp. 845 (profit motive the dominant factor in determining whether taxpayer engaged in business). His substantial investment, his background as a businessman and investor, his efforts to market and distribute the ampules in Argentina and realize a profit therefrom, all belie the conclusion that the 72,200 ampules were Section 1231 losses.

The record is devoid of any evidence that the ampules come within the ambit of the provisions of Section 1231. As matter of fact, the record leads to only one conclusion, that the ampules were property specifically excluded therefrom by Section 1231 (b) (1) (A) and (B).

Having established by a preponderance of the evidence, that petitioner was in the trade or business of producing and marketing drugs for sale, it necessarily follows that the loss incurred by the destruction of Kositerin was subject to the carry-back and carry-forward provisions of Section 172 and Reg. Section 1.172-4 (a)-1 (ii) and (vi).

B. The Tax Court declined to include in the cost of Kositerin the amount of 500,000 pesos, which was paid to the Martinis by petitioner. The amount represents the cost of raw material for 40,000 ampules of Kositerin, which made up part of the 72,200 ampules destroyed under the order of the Ministry of Public Health, February 17, 1956. (Exs. 48 and 49).

The Tax Court found that Stevan was financially aided for the new substance by Ada Bossard von Martini; that she advanced to him 500,000 A$P; that her son Franz empowered, because of her illness, to handle her financial affairs, contacted Stevan for repayment of the debt, which debt was paid by Marko in 1949. (54 TC at 3056).

The total cost for 72,200 ampules of Kositerin which petitioner invested is:

(1) 255,100 A$P invested in Duga, S.A. in 1948. (54 TC at 3057).

(2) 537,500 A$P the amount he paid to the stockholders in 1950. (54 TC at 3058).

(3) 500,000 A$P paid to the Martinis in December 1949; which totaled A$P 1,292,600. (54 TC at 3056).

The opinion of the Tax Court that the payment of 500,000 A$P by petitioner to the Martinis in 1949, "merely represented the gratuitous satisfaction of obligations in-

curred by Stevan during his early South American Research," (54 TC at 3074), is without any evidentiary or factual foundation.

Nowhere in the record is there an iota of evidence from which it can be concluded that petitioner's payment of 500,000 pesos was a gratuitous act, rather than based on business considerations. Further, Duga Argentina, was functioning and active up to at least February 17, 1956, the date the Kositerin ampules were destroyed. During this time petitioner's interest in Duga Argentina never ceased.

He was active in establishing Argentine costs of Kositerin to obtain a license to sell, and received decrees and certificates from the Argentine Ministry of Public Health relating to the sale of Kositerin.

It is irrational and inexplicable to state, in one breath, that upon the destruction of Kositerin, appellant suffered an ordinary loss of his investment in Duga Argentina, of 255,100 in 1948 and 537,500 pesos paid to other Duga investors in 1950 and, in another breath, to state that the 500,000 pesos payment in 1949 to Mrs. von Martini was a "gratuitous" act on his part.

Based on the petitioner's testimony, the reasonable inferences to be drawn from his background as an investor and business man, the compelling conclusion is that Kositerin cost should properly include the payment of 500,000 pesos to Mrs von Martini.

IV.

(a) Though Petitioner, His Brother And Wife, Were In The United States From 1949 To Mid-52 As Non-Immigrants For The Business Purpose Of Distributing Krebiozen, While They Continued To Maintain Their Domicile In Argentina, They Were Deprived Of The Right To Deduct Their "Expenses While Away From Home In The Pursuit Of A Trade Or Business" Under Title 26 U.S.C. §162 Because In Mid-52 They Attained Immigrant Status. The Disallowance Of The Living Expense Was Bottomed On A Novel Theory That They Intended In 1949 To Make The United States Their Home, If The Law Allowed. This Decision That A Realized Hope Establishes A Home Or Residence Presents A Question Never Decided By This Court Or Any Other Court, But Does Conflict With Home Or Residence As Defined Under The Immigration Laws. An Affirmative Declaration By This Court Will Resolve The Discrepancies Between The Taxation And Immigration Laws.

Petitioner's partner-brother and petitioner's wife came to the United States from Argentina in 1949, on temporary visas for business purposes. In like manner and on the same conditions, the petitioner joined them in February, 1950 (54 TC at p. 3059; Ex. 75; Tr. 277, 634, 635, 638, 639, 640). They continued their stay in such status until July 16, 1952, applying for, and receiving, extensions of their temporary visas from the Immigration and Naturalization Service. On July 16, 1952, the three were granted permanent resident status in this country by Special Act of Congress. In the almost three year interim their residence in Argentina was in no wise abandoned. They maintained their apartment, their business interests and their laboratory there (Tr. 183, 277, 300, 301, 302, 638).

It is the submission of the petitioner that he is entitled to expenses in the amount of $20,953.44 for this period as temporary living expenses while away from home.

The Tax Court, with some terseness, rejected that submission when made to it, holding:

> "Total expenses actually recorded in the journal amounted to $130,713.48. However, of this amount, $20,953.44 was attributable to living costs and was treated by Olga as temporary living expenses while away from home (Argentina). Since petitioner's stay in this country was from the start 'indefinite,' see *Leo M. Verner* [Dec. 25,952], 39 T. C. 749 (1963), as opposed to 'temporary,' see *Beatrice H. Albert* [Dec. 17,111], 13 T. C. 129, 131 (1949), we view these expenses as being personal in nature. See and compare secs. 7.871-2(a) and (b), Income Tax Regs. Accordingly, the $130,713.78 shown on Olga's books has been reduced by $20,953.44." 54 T. C. at p. 3072, fn. 27.

This determination of the Tax Court—especially a seemingly accepted distinction between the terms "indefinite" and "temporary"—is an innovation contrary to Statute and court interpretation. Initially we should dispose of the case authority upon which the Tax Court relied. The most casual perusal will reveal no basis for the reliance, nor the conclusion to which such purported reliance led.

In the case of *Leo N. Verner*, 39 T.C. 749 the issue was whether the per diem allowances paid to the petitioner were reimbursements for deductible travelling expenses incurred while away from home in the pursuit of the trade or business or if petitioner's home during the period under scrutiny was that of one Edwards; and, thus, per diem allowances were additional compensation for increased living expenses rather than reimbursement for deductible traveling expenses.

In the case of *Beatrice H. Albert,* 13 T.C. 131 the question was that "taxpayer had but one job and for personal reasons and, rather than to prosecute or develop the business, chose to reside at a long established home away from this particular place of employment."

The Tax Court's authorities are inapposite.

The status of an alien in the United States is established, not by semantics, but by law, particularly the Immigration and Nationality Act.

The Act and all other relevant law, knows no status that can even loosely be described as "indefinite." It knows only two classes of aliens: permanent residents and temporary visitors.

The effect of petitioner's and his family's visitors' visas, under Title 8, U.S.C. Section 1201(c), was contrary to an "indefinite" or "permanent" stay, tax wise, or otherwise. Title 8, U.S.C. Section 1101 (a) (15) (B) defines an alien or non-immigrant as:

> "(B) an alien * * * having a residence in a foreign country which he has no intention of abandoning and who is visiting the United States temporarily for business * * *."

Once accorded permanent residence status, we readily concede that the complexion of the Durovics' living expenses took on a different hue. See Title 8, U.S.C. Section 1101, (a) (15) (B). But prior to such recognition neither the Petitioner nor his wife nor his brother could change their status as alien immigrants in this country temporarily for business purposes.

There is no ambivalent status for aliens in this country such as respondent has proposed, and the Tax Court has accepted. The fact of the passage of the Special Act of

Congress does not relate back. Such fortuitous circumstance has been rejected by the only court of which we know to whom it was proposed as affecting the prior status.

> "These people, so far as this record shows, were in transit in good faith. They were actually en route through this country. In the words of the complaint, admitted by the Attorney General, they possessed 'also' the intention about remaining here. That they entertained 'a desire or purpose or intent' to take advantage of an opportunity afforded them by the laws of this country to remain here, if such an opportunity should offer itself, does not seem to us to smack of the unlawful or to negative their other basic intent to proceed through the United States as their transit visas required. The problem is the unlawfulness of the entries.
>
> "This case seems to us to fall within the doctrine of Brownell v. Gutnayer rather than the rule of the cases above cited. In Gutnayer we held that the fact that a duly accredited official of a foreign government entertained an intent to remain in the United States did not make his entry unlawful. So, too, an alien actually and in good faith in transit through the United States does not become an unlawful entrant because he entertains a desire, purpose or intent to remain here if the laws of the country permit him to do so. Such a purpose, so limited, could at best be only a hope." *Brownell* v. *Carija,* D.C.D.C. 254 F. Supp. 78, 80.

We submit that hopes realized do not operate retroactively to the origin of the hope for tax purposes. After fortunes—neither good nor ill—are not contemplated by tax laws, except where specific provision is made therefor. Compare III above.

(b) Where The Court Of Appeals Agrees With The Fact And Legal Premise Submitted By The Petitioner, The Law Cannot Tolerate A Conclusion Diametric To That Premise. We invoke The Supervisory Power Of This Court To Correct This Departure From The Accepted Course Of Judicial Proceedings.

The matter in (a) above and disallowance of recognized expenditures (to be discussed hereafter) are here merged as they are in the Court of Appeals decision.[6]

In that decision it is affirmatively stated:

> "While, as we have stated above, we hold that the two amounts ($20,953.44 [living expenses] and $4,372.66) eliminated from the $130,713.48 amount claimed by the taxpayer as expenses *were properly deductible,*" (App. 15)

and that:

> "As we understand the opinion, the United States expenditures of $52,693.69 at which the Tax Court arrived by halving the $105,387.38 figure (net after deducting the Durovics' living expenses of $20,953.44 and the monies advanced to the 'Institute' ($4,372.66 *which deduction we have approved above*), ..." (App. 16) (Bracketed material and emphasis supplied)

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[6] We recognize this is a ponderous case, and that the Courts below gave obvious time and effort to its resolution. The onus lays on the Internal Revenue Service. The Petitioner has tirelessly resisted this venomous attack since 1964, when the jeopardy assessment issued, and his property was seized—as it continues to be. This vigilance saw the rejection of the fraud charge in the Tax Court, and the partial additional relief granted by the Court of Appeals. But there, nonetheless, remain viable contests, that would be foremost in the ordinary case.

This, notwithstanding and bottomed on the apparent premise of the foregoing, the Court of Appeals, in outright contradiction, concluded:

> "We are satisfied the Tax Court * * *; correctly excluded (1) taxpayer's living expenses from October 1949 through June 1952; and (2) office maintenance of the Krebiozen Foundation." (App. 26)

By Petition for Rehearing, the inconsistency was brought to the attention of the Court. Rehearing was denied (one Judge dissenting) without further opinion nor elucidation. We submit that, if a litigant is to lose on these substantial items, it is a proper exercise of this Court's supervisory power to require that he be advised of some cogent reasoning which compels his loss, as opposed to cogent reasoning that should, but did not, compel his victory.

In this regard a short summary of the disallowed $4,372.66 figure follows:

The Tax Court disallowed expenses of $4,372.66 allocated for rent, telephone and mailing for Krebiozen Research Foundation, as "conceded to have been expended in furtherance of Institute [sic] as opposed to the partnership activities." (54 T.C. at p. 3027, fn. 27).

Krebiozen Research Foundation was an organization whose purpose was to promote, inform about and distribute the drug Krebiozen to the profession. The Foundation gathered all the results of the drug and suggested the dosage rate to the profession. The Foundation was an instrument of Duga Laboratories partnership. This was a nonprofit organization which until April 1954 carried out the distribution of Krebiozen without charge. (Tr. 642, 643 and 54 T.C. at p. 3061).

CONCLUSION

Wherefore, this Petitioner respectfully prays the Court to issue its Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit for the purpose of reviewing the limited issues hereinbefore presented.

Respectfully submitted,

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APPENDIX

In the United States Court of Appeals For the Seventh Circuit

SEPTEMBER TERM, 1972—APRIL SESSION, 1973

No. 72-1692

MARKO DUROVIC,

Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Appeal from the United States Tax Court, Washington, D.C. — No. 1633-65 — LEO H. IRWIN, *Judge.*

ARGUED APRIL 16, 1973—DECIDED OCTOBER 18, 1973

Before SWYGERT, *Chief Judge,* CASTLE and BARNES,* *Circuit Judges.*

BARNES, *Circuit Judge.*

This complex case comes to us as a timely petition to review a decision of the Tax Court of the United States. The Tax Court entered its decision on April 20, 1972, in accordance with its lengthy opinion, filed June 24, 1970, appearing in 54 U.S. Tax Court Rp. 1364 to 1402 (hereinafter "opinion").

The findings of fact of the Tax Court appear in said opinion at pages 1366 to 1383. Appellant's counsel states:

* The Honorable Stanley N. Barnes of the Ninth Circuit, sitting by designation.

"Those findings are correct and objectively set forth the evidence at trial. We would adopt them as a faithful statement of the evidence." (Opening Brief at 9).

This appeal, therefore, rests on the merits of appellant's claim that the Tax Court made erroneous conclusions upon the evidence before it.

Because of their length, we will not repeat the complete findings herein, but will assume a sufficiently interested reader of this opinion will have reviewed them himself. Some necessary facts, however, will be recited under the different issues presented.

I. FACTS, GENERALLY.

For several years in Argentina prior to coming to the United States, appellant Marko Durovic (a lawyer), aided, financially and otherwise, his brother, Stevan Durovic (a physician), who had been experimenting, and conducting research into the cause of cancer. It was the latter's theory "that if a proper stimulant for the reticuloendothelial system could be found, the defensive and reparative cells comprising this system could be made to produce a substance which would control malignant growth." (Opinion at 1367). In his experiments in Argentina, Stevan had unexpectedly separated a substance (named Kositerin) which showed activity against hypertension. Some of this substance was tested in 1949 at the School of Medicine at Northwestern University in Illinois. The results were uncertain. No Kositerin was sold in Argentina, but some 72,200 ampules of the substance was made and placed in storage there. The Minister of Public Health of Argentina later ordered these 72,200 ampules destroyed, as a result of spoilage, on February 17, 1956.

Meanwhile in 1947 Stevan, in Argentina, continuing his research in the area of cancer, came upon a new sub-

stance, called drug "X", later to be called Krebiozen. It was produced by a similar method to that used to extract Kositerin. It used the same horse and cattle blood, stimulated with a new substance, "actinomyces bovis" instead of "actinobacilus lignieris."

In 1949, both Marko's wife Olga (who spoke English) and Stevan traveled to the United States to interest and obtain financial backing for the commercial production of these drugs. The previous financial backers in the Argentine during 1947, 1948 and 1949 (Tanoira, et al), were holding 2 grams, 35 centigrams of Krebiozen as security for the moneys they had advanced. Marko borrowed M$N2 million pesos and paid some 3,005,000 pesos to Tanoira on January 26, 1950, so that Marko and Stevan could have all papers and products shipped to the United States and could continue their previous experiments (from 1951 on) in the United States, at the Duga Biological Institute. (On April 5, 1954, the name was changed to Duga Laboratories.) (Both are referred to as "Duga, Illinois" in the Tax Court opinion.) Duga, Illinois operated as an equal partnership between Marko and Stevan for the production, testing and distribution of the drug Krebiozen.

It was the partnership returns of "Duga, Illinois" which were filed with the collector in 1954 and which the appellant now urges *gave notice to the government that Marko had no individual income,* and allegedly commenced the running of the statute of limitations against the collection of deficiencies on any individual income taxes owed by the parties.

Although there is considerable dispute as to "cost of product", and a different total product cost used in the partnership 1954 return ($1,326,000) compared to the 1955-59 returns ($1,404,511.33); when divided by the number of capsules of drug "X" on hand (200,000 in 1951 and

136,097 in April, 1954), the 1954 computation asserted a cost of about $9.50 per ampule; the later computation about $10.32 per ampule.[1] We will consider other facts connected with product cost hereafter. We now turn to each issue.

II. STATUTE OF LIMITATIONS.

WHETHER THE TIMELY AND COMPLETE FILING OF PARTNERSHIP RETURNS . . . COVERING THE TAX YEARS HERE IN QUESTION, AND DISCLOSING THERE WAS NO INDIVIDUAL INCOME, COMMENCED THE RUNNING OF THE STATUTE OF LIMITATIONS FOR ASSESSMENTS AND COLLECTIONS OF ALLEGED DEFICIENCIES IN INDIVIDUAL INCOME TAXES AND ADDITIONS THERETO.[2]

We must decide what information is required on an individual taxpayer's return, as distinguished from that required and returned on this partnership return.

The partnership return showed:

	Received for Krebiozen	Cost of Goods Sold
1954	149,694.10	172,957.74
1955	205,936.73	319,682.64
1956	171,926.98	244,738.80
1957	263,336.53	344,244.24
1958	217,213.36	251,611.92

[1] The increase in total product cost was the addition of $78,511.33, claimed to have been incurred between May, 1951 and April, 1954, as reflected in the daily partnership records kept by Olga. The 1954 partnership return was never amended. It is undisputed that neither appellant nor his wife Olga filed any *individual* income tax returns for the years 1954 to 1958 inclusive, prior to March 10, 1965.

[2] Each side presents the issues in differing language. We discuss all issues raised.

Title 26 U.S.C. §6012(a) (I) (A) requires that an income tax return be filed by "every individual having for the taxable year a gross income of $600 or more." Taxpayer had, in each year mentioned above, a gross income of $600 or more. 26 U.S.C. § 61(a) (13), and 26 U.S.C. §701 (c). In addition, the taxpayer and his wife had interest on a joint savings account of $680.00 in 1957 and $891.28 in 1958, and no other income during the years 1954 through 1958. Taxpayers must file a return "according to the forms and regulations" prescribed by the Secretary, and must include therein the information required by such forms or regulations. (§6011(a)).

Title 26 U.S.C. §6031 requires that every partnership shall make an information return, stating its gross income and the deductions allowable, and such other information as the Secretary of the Treasury requires. But the partnership is not liable for any tax; the individual taxpayers, in their individual capacity, are; and all partners are required to report their distributive shares on their individual returns.

Appellant asserts that "by reason of the family tax exemptions and deductions, and the losses of the Duga partnership, no individual tax return was required to be filed by petitioner for any years 1954 to 1958". (Brief, at 10.) The fallacy of his argument is that appellant refers to *net* income, not the *gross* income of $600 or more specified in the statute, and required to be filed by every individual, whether or not a partner.

There is simply no way to equate the two terms and appellant cites no cases to support the theory that the partnership return, *standing alone,* is a sufficient return to toll the statute of limitations.

The *sine qua non* expressed in *Commissioner* v. *Lane-Wells Co.*, 321 U.S. 219 (1944) is that: "The returns did not show the facts on which liability would be predicated." (P. 223).

And see: Automobile Club v. *Commissioner*, 353 U.S. 180 (1957); *F. E. McGillick Co.* v. *Commissioner*, 30 T.C. 1130 (1958); *Danz* v. *Commissioner*, 18 T.C. 454 (1952).

Appellant next asserts that since the Tax Court determined there was no fraud with respect to the deficiency determined for any year (54 T.C. at 1399, cited as 54 T.C. at 3075, Opening Brief at 11), and that there were no substantial omissions from gross income, Section 6501 (e) of the Internal Revenue Code started the statute of limitations to run each year. This argument overlooks the fact that there is an exception to the "substantial omission rule" in §6501(e)'s opening paragraph:

> "Except as otherwise provided in subsection (c). . . ." Subsection (c)(3) provides:
>
> > "NO RETURN.—In the case of failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun, without assessment, *at any time.*" (Emphasis added.)

It is true that the partnership return filed by Duga Laboratories reported all of the appellant's actual income for 1954-56 and all income with the exception of dividend earnings of $681.00 and $891.28 for 1957 and 1958 respectively. Appellant asserts that under the rationale of *Germantown Trust Co.* v. *Commissioner*, 309 U.S. 304 (1940), this information was sufficient notice to the Commissioner of his tax liability to begin the running of the

statute of limitations. We cannot accept this argument which makes the running of the limitations period depend upon such happenstance. An individual income tax return, if filed, would have accomplished its statutory purpose of making the Commissioner's auditing task simpler by assuring him that petitioner claimed no other income, credits, or deductions other than the ones on the partnership return. The filing of an informational partnership return, upon which no assessment can be made within the meaning of 26 U.S.C. §6501, could not begin the running of the statute of limitations. We adhere to the reasoning of the Supreme Court in *Commissioner* v. *Lane-Wells,* 321 U.S. 219, 223-24 (1944), which refused to find that the filing of one return began the running of the period of limitations on a tax due under a second return that was not filed, even though the first return contained a "full disclosure of . . . gross income and deductions and . . . resulting net income" *Lane-Wells Co.* v. *Commissioner,* 134 F.2d 977, 978 n. 4 (1943):

> "Congress has given discretion to the Commissioner to prescribe by regulation forms of returns and has made it the duty of the taxpayer to comply. It thus implements the system of self-assessment which is so largely the basis of our American scheme of income taxation. The purpose is not alone to get tax information in some form but to get it with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns may be readily accomplished. For such purposes the regulation requiring two separate returns for these taxes was a reasonable and valid one and the finding of the Board of Tax Appeals that the taxpayer is in default is correct."

We find the Tax Court properly held the statute of limitations did not bar the action against appellant.

III. THE JEOPARDY ASSESSMENT

APPELLANT ASSERTS THE PATENT ILLEGALITY OF THE JEOPARDY ASSESSMENT AND CALLS FOR THE COURT'S INTERCESSION. THE GOVERNMENT ASSERTS THE ASSESSMENT WAS LEGAL, AND APPELLANT IS ENTITLED TO NO RELIEF.

Section 6861(a) of the Internal Revenue Code Appendix, provides that the making of such assessment is within the discretion of the Secretary or his delegate. Section 6861(c) permits either of the said officers (they *may*) to abate such assessment if he *believes* it to be excessive, "*before* the decision of the Tax Court is rendered". Congress, in its wisdom, has thus seen fit to give the Secretary or his delegate a wide discretion, but only prior to litigation over the tax.

This Circuit has previously held that this discretionary power is not subject to judicial review. *Veeder* v. *Commissioner,* 36 F.2d 342 (7th Cir. 1929) and *Kohler* v. *Commissioner,* 37 B.T.A. 1019 (1938), dismissed by this Court on September 10, 1940. We have heretofore noted that "jeopardy assessments are of their nature and purpose arbitrary." *Homan Mfg. Co.* v. *Long,* 242 F.2d 645 (1957).

Thus, while we might think the continuing jeopardy assessment, while perhaps originally reasonable, is presently unfair and unreasonable (and we do), we are with-

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[3] As the Commissioner states in his brief (at 39):

"Taxpayer cites no precedent for the relief he requests, and our research reveals none. The statute itself provides two forms of relief. Section 6861(g) of the Code, Appendix, *infra,* provides that the Secretary or his delegate may abate the jeopardy

out power to act.[3] The jeopardy assessment remains validly in force.

IV. IS THE PETITIONER ENTITLED TO FILE A JOINT RETURN WITH HIS WIFE, AND COMPUTE TAXES AT THE RATES APPLICABLE TO MARRIED PERSONS?

IV A.—FACTS.

We now add to the recital of facts that subsequent to the assessed jeopardy deficiency against appellant on October 28, 1964 and the statutory notice of deficiency, identical in amount, issued within the 60 day period prescribed on December 28, 1964, the taxpayer and his wife, Olga, filed on March 10, 1965, joint income returns for the years 1954 through 1958, purportedly pursuant to §6013(a) of the 1954 Internal Revenue Code.

(footnote continued)

assessment if he finds that jeopardy does not exist, provided that the abatement is made prior to a decision of the Tax Court or, if no petition is filed, prior to expiration of the period for filing such petition. Additionally, Section 6863(a) of the Code provides that collection of a jeopardy assessment shall be stayed if the taxpayer furnishes a bond. Under Section 6863(b)(2), of 'the Tax Court determines that the amount assessed is greater than the amount which should have been assessed, then when the decision of the Tax Court is rendered the bond shall, at the request of the taxpayer, be proportionately reduced.' Taxpayer has not availed himself of these forms of relief. Under such circumstances, the jeopardy assessment remains validly in force."

Appellee relies on the express exceptions mentioned in §6013(b) with respect to the rights given husband and wife taxpayers, under §6013(a), to file joint returns.[4]

IV B.—DISCUSSION.

The last taxable year here involved is 1958, and the last date prescribed by law for filing a 1958 return is April 15, 1959. The three years expired April 15, 1962. The appellants' joint return was filed March 10, 1965, almost three years too late for the last year with which we are concerned.

Appellant states that "§6013 has never been construed to bar an initial election to file a joint return made after the due date of a return". (Brief, at 21), citing one case—*Spanos* v. *United States,* 212 F. Supp. 861, fn. 3 (1963); and *Spanos* v. *United States,* 323 F.2d 108 (1963)—affirming in part, and reversing in part.

As the Tax Court stated, §6013(b) was passed by the Congress "to remedy the dilemma which often befell married taxpayers who were required to make a binding election (as to the type of return they would file) at a time when they lacked 'informed tax knowledge not possessed by the average person'" "It was to permit married persons, who originally elect to file individual returns,

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[4] Section 6013(b)(2) provides:

"The election provided for in paragraph (1) may not be made—

* * *

"(B) after the expiration of 3 years from the last date prescribed by law for filing the return for such taxable years, . . . or

"(C) after there has been mailed to either spouse, with respect to such taxable year, a notice of deficiency under Section 6212, if the spouse, as to such notice, files a petition with the Tax Court—within the time prescribed in Section 6213."

to later change their election, and file joint returns at any time within the three year period of the statute of limitations." (54 U.S.T.C. Rep. at 1401).

This same problem was faced by Mrs. Spanos after her husband had fraudulently failed to file a timely return for the year 1955, due April 15, 1956. On July 2, 1956, the husband and wife filed a joint return correctly setting forth their tax. Later that year, her husband died. The government sought a fraud penalty against her, even though she was innocent of any fraud, had no taxable income, and the tardy return was free from fraud.

Mrs. Spanos first took the position, as outlined in the Court of Appeals' *Spanos* opinion, "that a joint return belatedly filed is an ineffective election and imposed no legal obligation upon her. . . ."

The Court of Appeals, though reversing any liability on her for her husband's fraudulent failure to file a return by April 15, 1956, disposed of her other contention as appears in the margin.[5]

The Tax Court here reasoned—"had (Mr. and Mrs. Durovic) originally filed individual returns for these years (1954-58), their election in 1965 to file joint returns would have been untimely. We see no reason why the same rule should not obtain where, as here, no returns were originally filed. However . . . 'as the result of a

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[5] "For the reasons clearly set forth in its discussion of this contention, we conclude that the District Court correctly held that Mrs. Spanos, when she joined in the filing of the tardy joint return became jointly and severally liable with her husband for the tax liability disclosed by the return, and for all interest and penalties arising out of that filing which might thereafter be assessed." (323 F.2d 108, 109).

failure to file a return, the Commissioner has been required to make an election for the taxpayers . . . that election may not thereafter be altered.' *Spanos* v. *United States,* 212 F.Supp. 861, 864 (D. Md. 1963)."

Appellant, in opposing this view, asserts that petitioner and his wife did not file individual returns originally, therefore, there is no statute of limitations to commence the running of the time within to make an election under any applicable provision of the Internal Revenue Code of 1954 (Appellant's brief, at 25). No cases are cited in *support of this theory of law. Spanos, supra,* does not support it. Section 6013 prohibits an election after the expiration of three years *from the last date prescribed by law* for filing the return for each taxable year (without regard to any extensions granted). By no stretch of imagination can this statute be interpreted to mean a complete failure to file erases the date from which the 3-year limitation starts to run. Congress could not have intended to put such power in the hands of a recalcitrant taxpayer, where, as the Tax Court noted, our system of "taxation is based on voluntary disclosure." (at 1402).

We agree with the Tax Court that the petitioner was not entitled to an election on March 10, 1965 that he would file a joint return with his wife.

V. THE COST OF GOODS.

DID TAX COURT ERRONEOUSLY COMPUTE THE COSTS OF GOODS SOLD?

V-A. FACTS.

Petitioner, on January 21, 1950, in Argentina, paid 1,268,193 Argentine pesos for the formula and rights to manufacture the drug Kositerin. On January 26, 1950, he purchased a half interest in the drug "X" or Krebiozen for 3,500,000 Argentine pesos. Physically, he thus ob-

tained the then entire supply of raw material Krebiozen (2 grams, 35 centigrams) later manufactured into 200,000 ampules. On February 7, 1950, petitioner came to the United States, manufactured the ampules of Krebiozen, and without cost, gave enough of them to certain doctors and institutions for experimentation and other evaluation of their value in the treatment of cancer.

In 1954, when a demand for the ampules became evident, they were sold for the first time. To make the partnership return in 1955 for 1954, it became necessary to convert the petitioner's investment into United States dollar equivalents. Petitioner used the figure of 3.36 pesos to the United States dollar. He arrived at the figure of 4,280,000 Argentine pesos as the total cost of both Kositerin and Krebiozen, or $1,273,809.52.[6]

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[6] Earlier, in early 1951, petitioner and his brother sought tax advice from an attorney, and on April 23, 1951, sought a tax-exempt status for the Krebiozen Research Foundation, and a ruling establishing the cost of the 200,000 ampules of Krebiozen at $1,326,000 (See Tax Court opinion, at 1377). This included United States $377,438.39 as the cost of Kositerin, United States $894,345.23 as the cost of Krebiozen. On May 9, 1951, the Internal Revenue Service requested *additional information.* On May 31, 1951, the request was *withdrawn,* because "most of their (our) records in reference to the cost are in Argentina," and "because of passport and permit status they (we) cannot go to Argentina now to obtain these records." (See opinion, Note 9). The petitioner and his brother therefore, made a tentative letter agreement with Krebiozen Research Foundation to sell the 200,000 ampules to the Foundation (or Institute) provided the Institute could obtain from the Internal Revenue Service a ruling or closing agreement under Section 3760 of the Internal Revenue Code that the ampules would be "capital assets" of the Durovics and "any profit that they might be held to have made on the sale will be treated as long term capitol gain." Such a ruling was requested for the Institute, but was not granted. The request was subsequently withdrawn. No sale to the Institute was consummated.

The Tax Court found the cost of the Krebiozen ampules 3,005,000 Argentine pesos, and found that was the fair cost of the 200,000 ampules of Krebiozen produced in the United States. This would amount to $894,345 if we were to use petitioner's figure of 3.36 pesos per dollar.

V-B. DISCUSSION.

There were three principal differences however, between the figures claimed by petitioner, and those allowed by the Tax Court.

First, the *amount of research expenditures* in the United States.

The figure claimed by taxpayers as "research expense" admittedly included "extensive research relating to sterilizing, ampuling and packaging the drug,"[7] totaling $105,387.38.[8]

This figure was cut in half by the Tax Court, and one half allowed as "properly applicable to cost of goods sold. *Cohan* v. *Commissioner,* 39 F.2d 540 (2nd Cir. 1930)."

This cryptic statement relies on what has long been a land-mark case in tax law—one written by one of our most illustrious and revered judges. We assume the Tax Court relies on his language that "the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making." (*Id.* at 544).

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[7] Petitioner had borrowed 2,000,000 Argentine pesos from one Ferrari in January, 1950, to buy out Tonoira. After devaluation of the Argentine peso on August 29, 1950, a new agreement was made between petitioner and Ferrari that this loan be converted into United States dollars at 3.36 pesos per $1 or $600,000 United States dollars in round figures.

[8] 54 U.S. Tax Court Rep. 1364, p. 1394.

But in the *Cohan* case, Cohan kept no records whatsoever! His figures were pure guesses. Yet, Learned Hand thought he would not permit the Board to allow Cohan *Nothing* as deductible expenses.

Here the figures come from original records kept by Mrs. Durovic during a four and one-half year period.[9] While, as we have stated above, we hold that the two amounts ($20,953.44 and $4,372.66) eliminated from the $130,713.48 amount claimed by taxpayer as expenses were properly deductible, we consider the halving of the $105,387.38 established by the records stipulated into evidence was arbitrary and capricious, and is not supported by *Cohan* v. *Commissioner, supra,* and that the expenses of research should have been allowed in the sum of $105,387.38, instead of $52,693.69.

This would result in an increased cost basis for the 200,000 ampules, in favor of the taxpayer.

Second, the number of ampules sold.

Petitioner insists that the 200,000 figure should not be used, as the number of ampules produced (and as the Tax Court did), in determining ampule cost, but the figure of 136,097, the number of ampules remaining after Duga,

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[9] The original amount claimed as research cost was $130,713.48, substantiated by an expense journal maintained by Olga Durovic (54 U.S. Tax Court, 1381, Note 11). The Tax Court reduced this amount by $20,953.44 attributable to petitioner's living costs from October, 1949 to April, 1954, and $4,372.66 expended in furtherance of the Institute (Krebiozen Research Foundation—a proposed tax-exempt foundation). This left a net research cost of $105,387.38 (See 54 U.S. Tax Court, at 1394, notes 27 and 28).

Illinois had distributed 63,903 ampules to the medical profession, and to research, free of charge.

The Tax Court explained its holding, without the citation of cases, in the following language:

> ". . . Though we fully appreciate the altruistic as well as practical considerations which governed the choice of spreading cost over 136,097 ampules as opposed to 200,000 ampules, we are constrained to hold that for the years 1954 through 1958, this method of apportionment did not clearly reflect income."

Thus, says petitioner, the Tax Court refused to credit petitioner the costs of manufacture of the 63,903 ampules distributed without charge.

As we understand the opinion, the United States expenditures of $52,693.69 at which the Tax Court arrived by halving the $105,387.38 figure (net after deducting the Durovics' living expenses of $20,953.44, and the monies advanced to the "Institute" ($4,372.66, which deductions we have approved above), the balance of the $105,387.38 deduction sought was expended, because the partnership also incurred extensive research expenses, "as well as extensive expenses relating to sterilizing, ampuling, and packaging the drug." (Opinion, at 1394). Petitioners assert the amount expended in pure research in the United States was not more than $500.00.

We think it rather obvious that before Krebiozen could be sold in the United States, it would require certain approval and acceptance from the medical profession, from medical schools and from certain governmental agencies. It is undisputed factually that 63,903 ampules were so distributed without charge for such purposes.

We think that the attempt to gain acceptance of the drug Krebiozen by giving away samples to responsible physicians and medical schools was as much a business expense as the giving away of drug samples to physicians or tooth paste samples to dentists.[10]

Goods distributed free of charge should be treated as an expense for promoting good will,[11] or as an advertising expense, deductible as an ordinary and necessary business expenditure.[11a] Whatever way the expense of the goods distributed free of charge is to be deducted, they must have some cost for tax purposes. For this reason it is essential that the cost of producing the ampules should be spread over the 200,000 ampules actually produced. This case must be remanded, then, to permit the Tax Court to determine whether the taxpayer is to get a deduction for the cost of the 63,903 free ampules distributed as an advertising expense or as an amortizable good will expense.

Thirdly: *The proper conversion rate.*

Petitioner claims in his brief the applicable rate of exchange was "the basic buying rate," 3.36 M$N per United

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[10] As the Tax Court said in its opinion, with respect to another issue, "After all, 'Taxation is a practical matter' and should therefore, attempt to capture the realities of the situation in question." (Opinion, at 1390).

[11] Compare *Liberty Insurance Bank*, 14 B.T.A. 1428, 1435 (1929), with *Northwestern Yeast Co.*, 5 B.T.A. 232, 237 (1926).

[11a] *Cf. Richard Hosiery Mills* v. *Commissioner*, 29 F.2d 262 (5th Cir. 1928).

States dollar.[12] The Tax Court held the applicable rate of exchange was the "commercial rate" of 9.66M$N to the United States dollar. The problem we face is that the petitioners presently claimed a "basic buying rate" should be used, and no basic buying rate appears in the record considered by the Tax Court.

Joint Exhibit 23-P indicates the "official rate of exchange" Argentine pesos to American dollars was constant for many years at 3.36 to $1 up to August 29, 1950 (at which time it advanced 5.00 to $1) and remained there through 1954. The Argentine transaction by which the Krebiozen powder was brought to the United States occurred, as was stated above, on January 26, 1950. On that the "commercial rate" of exchange was apparently 9.66 pesos to $1 dollars. (Joint Exhibit, per stipulation, 23-P). That, at least, was the Tax Court's interpretation of the evidence.

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[12] Nowhere in the Tax Court opinion does it use the term "basic buying rate". (Opinion, Issue 2, at 1388-1390). Apparently this term came to petitioner's attention subsequent to the Tax Court hearing and decision (or at least subsequent to the hearing and briefing below.) Judge Irwin's opinion was filed June 24, 1970. On August 20, 1970, new counsel filed a "Motion to Reopen the Record for the Submission of Further Evidence." This was denied April 7, 1971.

This motion, apparently for the first time attacked the inadequacy of the Joint Exhibit 23-P; that it does not define "official rate" or "commercial rate"—nor does it take into consideration that each changed in 1950; (though not until August 29, 1950 for the "official rate"); nor does it "conform" to "the titles, figures and practices of the Reports of the Board of Governors of the Federal Reserve System of the United States." There seems to be no "official rate of exchange" for Argentina, though there is such an "official rate of exchange" for most, if not all, other countries.

The determination of this issue is not aided by the varying language used to describe the same matters sought to be described. The opinion of the Tax Court refers only to "official rate of exchange", and "commercial rate of exchange". (See note 11.) Title 31, §372(b) and (c) now relied on by petitioner in his brief, refers to "the buying rate in the New York market", and "the buying rate for cable transfers", but these were apparently not in evidence before the Tax Court. Even these definitions are obscured, as to Argentina alone, by four apparent separate "buying rates" for that country from January 16, 1950 to January 27, 1950:

Argentina-basic	29.7778	American	cents	for	pesos
Argentina-Preferential "A"	20.6949	"	"	"	"
Argentina-Preferential "B"	17.4562	"	"	"	"
Argentina-Special	13.8958	"	"	"	"

Apparently these existed until August 29, 1950, when a rate designated "preferential" replaced preferential "A", and preferential "B", and the "special rate" was discontinued. The "basic rate" remained the same (29.778 cents for the peso until August 28 (or August 29), 1950. The "preferential rate" came into being at that time at 13.333 cents per peso, and the "free rate" came into existence two months earlier in July, 1950, at 11.100 cents per peso. (See Appendix, Petitioner's Brief, Exs. A., B. & C. and Ex. 62.)

The documents in the Appendix attached to petitioner's brief apparently were not introduced into evidence before the Tax Court, for the petitioner asks this Court "to take

judicial notice of those releases and bulletins reprinted herein." (Petitioner's brief, at 29).

Respondent challenges petitioner's use of the material attached to his brief; charging that petitioner seeks "to disavow the commercial rate schedule freely stipulated to by the parties (Joint Exhibit 23-P)" and used partially by the Tax Court in its opinion — (Table, Opinion at 1388).

The Tax Court opinion stated its "research had failed to uncover any cases that are on all fours with the question before us" (at 1389), citing *Morris Marks Landau*, 7 T.C. 12 (1946); *Estate of A.H.G. Fokker*, 10 T.C. 1225 (1948); and *Credit & Investment Corp.*, 47 B.T.A. 672 (1942).

The Tax Court then said:

> "In almost all these cases Commissioner asserted deficiencies based upon the official rate of exchange. *See Ceska Cooper*, 15 T.C. 757 1950); *Estate of Meinhuys*, 17 T.C. 1149 (1952); and *Credit & Investment Corp., supra.* However, in each instance the courts were unwilling to accept this argument when it was patently clear that the official rate of exchange did not reflect the exchange rate at which foreign currency could be traded for United States dollars", citing *Ceska Cooper, supra*, at 765.
>
> "United States taxation is 'based on the value of property measured in United States dollars.'
>
> ". . . where gain or loss must be computed it is the actual cost of the investment in the terms of the number of dollars needed . . . which establishes basis, and the obtainable dollar equivalent of the currency received."

Thus the court concluded it should use the "*actual dollars worth in terms of salient market conditions*", and held the commercial rate of exchange should be used. (Opinion, at 1390).[13] Can it be said here that "it is patently clear that the official rate of exchange did not reflect the exchange rate at which foreign currency *could be traded* for United States dollars" (emphasis added) in January, 1950?"

In coming to its pragmatic endeavor to adopt

> "a rule of reason which reflects *actual* dollars worth in terms of salient market conditions", and "the realities of the situation", the Tax Court cites *Edmond Weil, Inc.*, a memorandum opinion dated August 9, 1944 (Opinion, Note 21 at 1390), in which the Tax Court used the commercial rate of exchange where the "evidence [established] that petitioner was never paid the 'official' rate in exchange transactions."

In considering the Tax Court's conclusions we note (a) that Joint Exhibit 23-P, was stipulated into evidence as proof the "official rate of exchange" was 3.36 *up to* August 29, 1950; and the "commercial rate of exchange", 9.66 *throughout* 1950; (b) that the relevant dates are January 26, 1950, and February 7, 1950 (when the Krebiozen powder was bought and brought into the United States); (c) that there was no evidence before the Tax Court that there existed any restrictions making the use of the "official rate" impossible. (Ex. 62).

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[13] In addition to the five Tax Court cases and the one Board of Tax Appeals case hereinabove mentioned, the Tax Court cited as the basis of its conclusion the following:

Willard Hellburn, Inc., 20 T.C. 740 (1953); *Edmond Weil, Inc.* v. *Commissioner*, 150 F.2d 950 (2nd Cir. 1945); and *James Q. Wheatley*, 8 B.T.A. 1246, 1249 (1927) and in note 20, *Elder* v. *Commissioner*, 138 F.2d 27 (2nd Cir. 1943).

When the Argentine peso began to cheapen with respect to the American dollar, the banker who had lent petitioner roughly 2 million Argentine pesos in January, 1950, apparently became sufficiently worried by the slump in the peso's value to travel to Chicago to discuss the rate of exchange to be used by the parties. The loan was converted by mutual agreement of the parties into United States dollars at the rate of 3.36 pesos for one dollar. The rate used was the "official rate" described in Exhibit 62, which was based on the "buying rate" determined by the Board of Governors of the Federal Reserve System in New York for the two weeks ending January 30, 1950. While we do not agree with appellant that this *post facto* recognition of an exchange rate to be used by agreement of the parties to the transaction binds the government in the collection of income taxes, neither are we impressed with the position of the Tax Court that despite the fact it can find no cases on all fours with the facts of this case, it is "the inescapable conclusion" (Opinion, at 1389) from the cases it cites, *supra,* and Note 13, *supra,* the commercial rate of exchange "actually determines the number of dollars which reasonable businessmen, dealing at arms length will be willing to pay for a commodity at a given time." For, here, in the transaction under scrutiny, it did not. A figure different than the commercial rate, was utilized, agreeable to the understanding of the parties.

Further, in *Eder* v. *Commissioner,* 138 F.2d 27, at 28 (1943), Judge Frank wrote:

> "We agree with the taxpayer that the Commissioner and the Tax Court were in error in adopting as the value of 'blocked' pesos the current rate of exchange for 'free' pesos."

Judge Frank goes on to say this does not mean the taxpayer must win, however, because it may have been possible for the taxpayer to show the value of "blocked" pesos in Columbia, and that he could have invested or spent them there; thus obtaining economic satisfaction. But there was no evidence in that record "to show how economic satisfaction in Columbia can be measured in American dollars". The Court therefore remanded the case to the Tax Court for further consideration of the appropriate measure of valuation.

Here the Argentine pesos were not "blocked", hence *Eder, supra,* is no authority for the position that the current rate of exchange for "free" pesos could not be used, nor is it authority for the position that the exchange rate for "free" pesos should be used.

The *Fokker* case *supra,* likewise deals with blocked Dutch guilders. We note, however, that Judge Arnold of the Tax Court wrote the following significant *dicta*:

> "What rate of exchange shall be used in converting Dutch guilders into American dollars? There would be no problem if the valuation could be made at the date of decedent's death. At that time the official rate of exchange was $0.531 per guilder. (Emphasis added.) But the executor chose, as was his right, the date for evaluation as one year after death. The Tax Court followed *Landau, supra,* and valued the then blocked Dutch guilders at 5 cents per guilder."

Credit & Investment Corp. v. *Commissioner, supra,* likewise involved "blocked" German marks, and *Estate of Jan Wilhelm Nienhaus, supra,* involved "blocked" Dutch guilders (valued at 10 cents per guilder). *Wheatley, supra,* involved a loss sustained in purchasing Argentine pesos, but if anything, favors taxpayer.

The Commissioner's Brief cites several of the same cases mentioned in the opinion involving "blocked" currency, and adds the following cases: *Cooper* v. *Commissioner*, 15 T.C. 757 (1950); *The Foundation Company* v. *Commissioner*, 14 T.C., 1333, 1355 (1950).

Here the Commissioner's Brief states it is "[T]he inevitable conclusion dictated by the foregoing cases . . . that the commercial exchange rate must be applied in the instant case." (Brief, at 29). Referring to the taxpayer's position dealing with appropriate conversion rates for assessing duties on imports, and that the "buying rate" for cable transfers is the proper conversion rate, the Commissioner states:

> ". . . both the statute cited (31 U.S.C. §732(b) and (c) and the case (*Barr* v. *United States*, 324 U.S. 83 (1945)) relate to custom duties and have no bearing upon proper conversion rates to be used in conjunction with questions arising under the Internal Revenue Code."

But the Commissioner cites no cases or statutes which support such a broad general statement. In *The Foundation Company, Petr.* v. *Commissioner*, 14 T.C. 1333, "blocked" Chilean pesos prevented the use of an official rate, and Judge Harron held:

> "We have come to the conclusion that the loss is properly computed, in this proceeding and under its particular facts, by using the 'free' rate of exchange, and the 'free' rates on the dates petitioner received the respective payments in 1931, 1932 and 1933." (*Id.* at 1355).

This ruling was followed in *Ceska Cooper*, 15 T.C., 756, 765, relying on *Landau* v. *Commissioner*, 7 T.C. 12, "The official rate of exchange does not apply to blocked

pounds." The Cooper case concludes: "The Commissioner has used in his determination of the deficiencies the official rate of exchange of the pound. This, we hold, was error on his part, and the free rate of exchange should be used instead. *But see The Foundation Company* v. *Commissioner*, 14 T.C., 1333. As to this issue, the petitioner is sustained."

On this admittedly very unsatisfactory and unclear state of the law; (a) because of the efforts of petitioner to have us consider evidence not introduced below by taking judicial notice of it; (b) because of the flat statements of the petitioner that Title 37, §372(b) and (c) controls not only conversion of foreign currencies with respect to Custom's collection of duties, but also with respect to all tax matters, and the failure of either side to present controlling law or convincing analogy; (c) because *Barr* v. *United States,* 324 U.S. 83, although referring specifically to "the search which has been made for a measure of the true dollar value of *imported merchandise for customs purpose";* and the right of Congress "to choose any standard of evaluation *for the assessment and collection of duties",* allegedly prevents any judicial review of the determination and certification by the Federal Reserve Bank of New York, of the *"buying rate"* to be used in all foreign currency conversion to which the Commissioner states this case "has no bearing" on our problem: (d) because petitioner seeks to be released by this court from his stipulation with respect to Joint Exhibit 23-P; (e) because Exhibit C in the Appendix, attached to Appellant's Brief, if properly introduced into evidence, indicates there was no such thing as an authorized "commercial rate" or "free rate", or "preferential rate", or anything other than a "basic" foreign exchange rate for Argentine pesos prior to the end of June,

1950; (f) because the Commissioner in support of the Tax Court relies almost exclusively on "blocked currency" cases; (g) because the Commissioner relies on "inevitable conclusions" that do not seem to be required by the cases submitted, which largely rest on a different factual basis; and (h) because we believe the matter must be remanded to the Tax Court for recomputation in view of our findings as to number of ampules (Issue IV-A), we reverse the Tax Court on the issue of conversion values and remand for further exploration of the law and the fact, and a proper determination of that issue.

We are satisfied the Tax Court correctly ruled that taxpayer's investment in Kositerin was not part of the cost of Krebiozen sold; correctly excluded (1) taxpayer's living expenses from October, 1949 through June, 1952; and (2) office maintenance of the Krebiozen Foundation.

We have likewise concluded we can give no relief to the petitioners with respect to the jeopardy assessment.

Due to the unusual delays heretofore encountered in this matter, and the additional delays necessitated by the length of the record before us, we recommend that the Secretary of the Treasury, or his delegate, consider the advisability of raising the jeopardy assessment against petitioner with the use of amply sufficient bonding procedures.

Affirmed in part; reversed in part, and remanded in part for further consideration by the Tax Court in accordance with this opinion.

SWYGERT, *Chief Judge, dissenting in part.*

If we are to adhere to 26 U.S.C. § 6501 and the cases which have interpreted its predecessors, taxpayer must be held free from an assessment of tax for the fiscal years 1954 through 1958. The statute of limitations has run against the Commissioner. Accepting, *arguendo,* the opposite conclusion, I am at a loss to understand why it is that taxpayer—being newly apprised of an assessment of tax by the Commissioner—was not, like any other taxpayer filing a return for the first time, allowed to exercise the option of filing a joint return with his wife, rather than being taxed at an individual rate.

I

The argument of the Commissioner on the question of the statute of limitations is essentially this:

> [U]se of partnership returns in conjunction with individual returns may help the Commissioner to ascertain a taxpayer's total gross income and, in that respect, may lessen the need for a period of limitations longer than three years in which to audit a taxpayer's return and compute his taxes. This fits into a larger rationale behind the period of limitations provisions, *i.e.,* that the Commissioner should not be limited to a three-year period unless he is furnished with *all* of the data necessary to compute a taxpayer's income. Such needed data, in the case of a partner, include not only his distributive share of partnership gross income, but income from other sources, exemptions, deductions, and credits. App. Br. at 18, 19.

The majority reach their decision on exactly this basis, noting, too, that 26 U.S.C. § 6501(e)—which deals with substantial omissions from gross income reported on a return—is inapplicable by reason of a proviso appended

thereto which makes an exception for cases where there has been a "failure to file a return." The majority add their estimation that the failure of Durovic to file Forms 1040 for the years in question contributed impermissibly to the Commissioner's task of auditing, and observe that a holding for Durovic on the authority of *Germantown Trust Co.* v. *Commissioner,* 309 U.S. 304 (1940), would foster situations in which the applicability of the limitations statute would depend on some undefined "happenstance." I submit that these various rationales do not stand penetrating analysis.

The overall statutory scheme of 26 U.S.C. § 6501 is more complex than a first reading suggests. Subsection 6501(a) sets down the general rule of limitation on assessment and collection:

> Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

Six years, however, is allowed the Commissioner for an assessment when a taxpayer has made a "substantial omission of items" within the meaning of subsection 6501(e)(1)(A):

> If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after

the return was filed. For purposes of this subparagraph—

> (i) In the case of a trade or business, the term "gross income" means the total of the amounts rereceived or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and
>
> (ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item.

By their very terms, neither provision applies when "no return" is filed.[1] In that event, by virtue of subsection 6501(c) (3), the Commissioner may assess a tax whenever he chooses:

> *No return.*—In the case of failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

The central problem of this case lies in determining the meaning of the word "return" as used in the statute. Given subsection 6501(e), of one thing we may be sure: A return may on its face omit a substantial amount of gross income—well over twenty percent of the whole, in fact—and still be a "return" within the meaning of section 6501.

In this light, it is curious that the Government makes an argument, based on some "larger rationale" of section 6501, that "the Commissioner should not be limited to a

---

[1] Subsection 6501(e) opens with these words: "Except as otherwise provided in subsection (c)— . . . ,"

three-year period [for assessment] unless he is furnished with *all* of the data necessary to compute a taxpayer's income." Whether or not things "should" be this way is an issue beyond our province; the Government must address its argument to the wisdom of Congress, which has to date provided that the Commissioner has three years at most for an assessment when he is made aware of eighty percent, not all, of the gross income of a taxpayer.[2] It is of no significance, then, that the partnership

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[2] The Government is confused in its interpretation of *Germantown Trust Co.* v. *Commissioner*, 309 U.S. 304 (1940); that case did not hold that a "return" must contain all of the data necessary to compute tax or income. Germantown Trust Company had filed in 1932 what was essentially an informational return as a fiduciary of the beneficiaries of a trust which it administered. I say "informational return" because the beneficiaries, not the Company, were liable for tax on trust income. Some three years later, the Commissioner determined that the Company was a corporation and taxable as such. The relevant statutory material in effect at the time was contained in sections 275 and 276 of the Internal Revenue Code of 1932. The former section provided in part:

> Except as provided in section 276—
>
> (a) *General Rule.*—The amount of income taxes imposed by this title shall be assessed within two years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.
>
> * * *
>
> (c) *Corporate and Shareholder.*—If a corporation makes no return of the tax imposed by this title, but each of the shareholders includes in his return his distributive share of the net income of the corporation, then the tax of the corporation shall be assessed within four years after the last date on which any such shareholder's return was filed.

Section 276, subsection (a), provided:

> *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or a failure to file a return the tax may be assessed, or a proceeding in court

returns filed by Durovic did not disclose his income from other sources.[3]

(Footnote continued)

> for the collection of such tax may be begun without assessment, at any time.

The primary issue raised on appeal to the Supreme Court was whether subsection 275(a) or subsection 275(c) was controlling. The Court went along with the Company, holding precisely this:

> It cannot be said that the petitioner, whether treated as a corporation or not, made no return of the tax imposed by the statute. Its return may have been incomplete in that it failed to compute a tax, but this defect falls short of rendering it no return whatever. 309 U.S. at 310.

The Court, admittedly, was careful to note that the return was incomplete in no other way, citing the fact that the return "contained all of the data from which a tax could be computed and assessed." 309 U.S. at 308. But by no exercise of caution could it have held that the disclosure of something less would have rendered the fiduciary return "no return" within the meaning of subsection 275(c), for it was presented with a situation of full disclosure. Had, moreover, the Court ruled that an omission of gross income moved a filing from the realm of subsection 275(a) to that of subsection 275(c), its ruling would have had an applicability limited to events occurring before 1934, when section 275 was amended to include, for the first time, the predecessor to subsection 6501(e)(1)(A). That provision, subsection 275 (c) of the Revenue Act of 1934, 48 Stat. 745 (May 10, 1934), reads as follows:

> OMISSION FROM GROSS INCOME. If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

As a final observation, I might add that *Germantown* held *sub silentio* that subsection 276(a)—the ancestor of subsection 6501 (c)(3)—was inapplicable to the facts of that case.

[3] This extra-partnership income, the Government concedes, cannot comprise a sum even closely approaching twenty percent of Durovic's gross income for any of the years in question.

Of what other omissions does the Commissioner complain? In short, his argument is addressed to missing "exemptions, deductions, and credits" to which Durovic may have been due. This contention, however, is naive at best and disingenuous at worst. With no intention of cynicism, I submit that the Commissioner cares not a whit for the deductions or other items which serve to reduce the amount of tax he ultimately receives from taxpayers. Nor should he. His function is to see to it that income is fully reported and that the deductions which are taken do not exceed the proper amount. In what is essentially an adversary scheme, it is left to the taxpayer to assert his entitlement to credits or deductions and to litigate the question of his right thereto when the Commissioner is in disagreement. In mute testimony to this arrangement are the legions of agents and auditors who are employed by the Internal Revenue Service to bring to light unreported income and overstated deductions—not to unearth deductions or credits which the taxpayer may have overlooked. This is not to say, of course, that the agents of the Commissioner will not reveal to a taxpayer a neglected deduction when they come across it. I have no doubt that this is done. My point is simply that the Commissioner is not engaged in that practice as an everyday matter, and that the taxpayer, not the Commissioner, suffers when a return fails to claim or omits information relating to a deduction. The views of the Government, I conclude, are of no help to the majority.

Except to the extent that the statute, soundly construed, reveals what may be omitted from a "return" without depriving it of that status for the purpose of section 6501, the definition of a "return" is not found in the statute. The key to the concept may be found, instead, in *Commissioner* v. *Lane-Wells Co.*, 321 U.S. 219 (1944). The

Company in that case had filed a corporate return for each of the fiscal years 1934 through 1936. It did not concurrently file a return as a holding company— a duty imposed on every corporate taxpayer who qualified for an additional tax as a holding company—and expressly denied being a taxable holding company by answering in the negative a question directed to that liability which was set out on the corporate tax forms it filed. In a ruling which reaffirmed the earlier case of *Commissioner* v. *Germantown Trust Co.*, 309 U.S. 304 (1940), the Supreme Court held that the failure of the Company to file for each year a return relating to the tax on it as a holding company brought the case within subsection 276(a) of the Revenue Act of 1934, which allowed assessment "at any time." The acceptance by the Court of *Germantown*—which had held that a wrong return which disclosed all of the information upon which a tax could be computed failed to be "no return" within the meaning of subsection 275(c) of the 1932 Revenue Act—was dictated by the fact that the Court of Appeals for the Ninth Circuit had found that the returns filed by Lane-Wells "showed all the facts necessary for the respondent [Commissioner] to compute the taxes as a personal holding company obligation." *Lane-Wells Co.* v. *Commissioner*, 134 F.2d 977, 978 (9th Cir. 1943). The Supreme Court held, however, that more than this was needed to make the corporate returns at issue "returns" of the holding company tax:

> But it seems admitted that the returns did not show the facts on which liability would be predicated. Such liability was expressly denied by the return, and to obtain data on which corporations subject to the tax could be identified and assessed was the very purpose of requiring a separate return addressed to that liability. 321 U.S. at 223.

Here, I submit, is the definition of a "return." To qualify as such with reference to a particular tax, a completed tax form must disclose "the facts on which liability [for that tax] would be predicated." How this phrase is to be interpreted in the setting of *Lane-Wells* is of crucial importance to this case, for if the Court meant that an affirmative response by the Company to the inquiry made on the corporate returns relative to its holding company status would have constituted a disclosure of the "facts" necessary to make the corporate forms "returns" of the holding company tax, I cannot conceive of the reasoning by which the majority affirms this case on the authority of *Lane-Wells*. Durovic filed partnership returns which disclosed well over $600 of gross income for each of the fiscal years in question. As the majority recognizes, the Commissioner could not have asked for a clearer signal that he was due individual income tax returns from Durovic.[4] This disclosure cannot be distinguished from the affirmative answer which the Company could have made in *Lane-Wells*.

The majority, however, read *Lane-Wells* to hold that two separate returns must be filed if two are required by the Commissioner, citing a paragraph of the *Lane-Wells* opinion which makes reference to the importance of "self-assessment" by taxpayers and the need of the Commissioner for the filing of tax information "with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns may be readily accomplished." Putting aside for the moment the question of the quotation, I submit that the basic position

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[4] The partnership returns which were filed disclosed Durovic's name and address; the Commissioner thus had no difficulty in locating Durovic for the purpose of an assessment.

of the majority is in error. Why would the Court have made reference to the failure of the corporate returns to disclose "the facts upon which liability would be predicated" if similar returns which had disclosed those facts would nonetheless have been inadequate? And if the rationale for their view is that the Commissioner is unduly burdened by having to make out a second return, I must point out that the Government has not made that complaint to this court, and, too, that the Court in *Germantown*—recognizing that the Commissioner "prepared from the Form 1041 return, a substitute corporation return on Form 1120," 309 U.S. at 306—did not see fit to abstract from a silent record some need on the part of the Government. I would follow the example of *Germantown* and let the Government argue its burden if it must.

I turn, finally, to the quotation from *Lane-Wells* which the majority advance in support of their view. The passage which directly precedes the quotation reads:

> Taxpayer says that the information called for by [holding company] Form 1120H is information that could have been called for by Form 1120. We assume so, but we do not see how the fact helps the taxpayer, for the Treasury was fully within the statute in requiring that information in a separate return. 321 U.S. at 223.

Given this, the concluding sentence of the quotation bears repeating:

> [T]he regulation requiring two separate returns for these taxes was a reasonable and valid one and the finding of the Board of Tax Appeals that the taxpayer is in default is correct. 321 U.S. at 224.

I cannot help but conclude, respectfully, that my colleagues take the quotation out of context. The language by the Court referring to "self-assessment" and the

"physical task" of the Commissioner was in response to a challenge to the regulation requiring two separate returns, a particularly inappropriate contention given the rationale which the Court found to underlie the regulation: "[T]o obtain data on which corporations subject to the [holding company] tax could be identified and assessed was the very purpose of requiring a separate return addressed to that liability." 321 U.S. at 223. The quotation proffered by the majority cannot, I think, be taken to modify the essential holding of *Lane-Wells*, namely, that a return of one tax constitutes the return of another if, as to the other tax, the facts upon which liability would be predicated are shown.

There can be little doubt that those facts were shown with respect to the individual income tax liability of Durovic by the partnership returns he filed. Whatever hesitance may exist on that score disappears when the reaffirmation of *Germantown* in *Lane-Wells* is considered. From what little appears in *Germantown*, a taxable entity was not in 1932 required to file both a fiduciary and a corporate return. One or the other sufficed.[5] It follows that the filing of one of two returns, alternatively required, qualifies under *Lane-Wells* as a disclosure of the facts upon which liability would be predicated on the unfiled return. In significant contrast, the returns which were filed in this case did not merely suggest that other returns might be due; they each disclosed a fact—gross individual income of over $600—which left no doubt that individual income tax returns were due. Taxpayer, I submit, filed

[5] Were it otherwise, that is, were both required, *Germantown* and this case would be indistinguishable except for the irrelevant fact that the forms filed by Durovic were incomplete in minor respects.

returns of his individual income tax for the fiscal years at issue.[6]

II

The majority ascribe three reasons to their reluctance to overturn the decision of the Commissioner to file individual returns rather than a joint return for Durovic and his wife. The first of these is contained in this passage:

> The Tax Court here reasoned—"had (Mr. and Mrs. Durovic) originally filed individual returns for these years (1954-58), their election in 1965 to file joint returns would have been untimely. We see no reason why the same rule should not obtain where, as here, no returns were originally filed.

I disagree. All that need be cited in answer is a portion of 26 U.S.C. § 6013, the statute which authorizes and regulates the filing of joint returns by husband and wife:

> (a) *Joint returns.*—A husband and wife may make a single return jointly of income taxes under subtitle

---

[6] I have not dealt directly with the majority's argument that my position would make "the running of the statute of limitations depend upon . . . happenstance." Taking upon myself the liberty of clarifying this argument, I assume that the "happenstance" to which they refer is whether or not a taxpayer reports all of his gross income. Having done so, I understand the argument no better. While it is true that the applicability of the statute of limitations set out by subsection 6501(a) will be dependent upon a full disclosure of gross income, it is not true that no other statute will apply in the event of less than full disclosure. Either a three-year or six-year limitation would come into play, depending upon whether the taxpayer omits less or more, respectively, than twenty-five percent of the gross income disclosed on his return. 26 U.S.C. § 6501(e).

A, even though one of the spouses has neither gross income nor deductions, except as provided below:

[inapplicable]

* * *

(b) *Joint return after filing separate return.*—(1) *In general.*—Except as provided in paragraph (2), if an individual has filed a separate return for a taxable year for which a joint return could have been made by him and his spouse under subsection (a) and the time prescribed by law for filing the return for such taxable year has expired, such individual and his spouse may nevertheless make a joint return for such taxable year.

* * *

(2) *Limitations for making of elections.*—The election provided for in paragraph (1) may not be made—

* * *

(B) after the expiration of 3 years from the last date prescribed by law for filing the return for such taxable year (determined without regard to any extension of time granted to either spouse); . . .

The fact that subsection 6013(b)(2) is specifically limited in application to cases falling within subsection 6013(b)(1) is, to my mind, a quite sufficient reason to distinguish cases where no returns are originally filed and those where an individual "has filed a separate return for a taxable year for which a joint return could have been made by him." 26 U.S.C. § 6013(b)(1). We are told, however, that Congress intended subsection 6013(b)(2) to have a broader reach than its literal reading would suggest:

> Section 6013 prohibits an election after the expiration of three years *from the last date prescribed by*

> *law* for filing the return for each taxable year (without regard to any extensions granted). By no stretch of imagination can this statute be interpreted to mean a complete failure to file erases the date from which the 3-year limitation starts to run. Congress could not have intended to put such power in the hands of a recalcitrant taxpayer, where, as the Tax Court noted, our system of "taxation is based on voluntary disclosure."[7]

To what "power" in the recalcitrant taxpayer do my brothers refer? It is, I assume, the power to refuse or neglect to file a return. But I fail to see the reason for reading into section 6013 a purpose to foster voluntary disclosure by a taxpayer when numerous other provisions of the Internal Revenue Code are specifically aimed at his obstinance. See 26 U.S.C. §§ 6651, 7203; 26 C.F.R. § 301.6651-1. Can it be said that the foreclosure of an option to file jointly will appreciably spur a return of tax by a couple who are willing to take the risk of a penalty? I would hesitate so to assert. What lies implicit at the root of the second justification advanced by my colleagues is, I opine, a conviction that the disinclination of a taxpayer to make a voluntary disclosure of his liability may be gauged by his readiness to file a return. This view, however, compounds the error the majority make in dealing with section 6501. As I have demonstrated, a return may disclose only a portion of a taxpayer's gross income—as little, I suppose, as is needed to show liability—and still be a "return" for the purposes of certain tax laws. Thus, the taxpayer who files a return may be as recalcitrant or dishonest as the one who does not. Add to these ob-

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[7] For a similar argument see *Dritz* v. *Commissioner*, 28 T.C.M. 874, 879-80 (1969), which erroneously suggests that section 6013 gave spouses a "privilege" of making their returns jointly.

servations the fact that the legislative history of section 6013 gives no hint of a Congressional purpose to encourage voluntary disclosure by section 6013, and the conclusion becomes inescapable that subsection 6013(b)(2) must be limited, as it states on its face, to situations where a return which elects individual filing status has been made.

Spanos v. *United States*, 212 F. Supp. 861 (D. Md. 1963), constitutes the final authority in support of the majority decision. The plaintiff in that case, seeking to avoid a fraud penalty based on a return jointly filed by her and her husband, argued that a taxpayer could not legally make a determination to file a joint return after its due date. The district court did not agree:

> As the Commissioner points out, in the absence of the special factors present in the authorities cited by the taxpayer, administratively the Act has not been construed to bar an initial election made after the due date of a return. 212 F.Supp. at 864 n. 3.

The authorities cited by the taxpayer to which the court made reference were employed to support the following dicta, that upon which the majority rests its holding:

> [T]he cases introduce into § 6013 the principle, founded upon equitable considerations, that if an election has been made and acted upon by the Commissioner, or if, as the result of a failure to file a return, the Commissioner has been required to make an election for the taxpayers (or change an election due to a spouse's valid nonacquiescence), that election may not thereafter be altered. 212 F.Supp. at 863-64.

The most significant point of this statement is that "equitable considerations"—not some statutory construction—are the underpinning of the rule it espouses. The cases upon which the rule rests, then, are highly pertinent to deter-

mining the kind and nature of equities which arise when an election of filing status is made by the Commissioner.

The cases are three in number: *Grant* v. *Rose*, 24 F.2d 115 (N.D. Ga. 1928), *aff'd Rose* v. *Grant*, 39 F.2d 340 (5th Cir. 1930); *Grobart* v. *Commissioner*, 20 T.C.M. 629 (1961); and *Mundy* v. *Commissioner*, 14 T.C.M. 1067 (1955). Of these, only *Grobart* and *Mundy* are particularly apposite to this case: *Rose* was a case where taxpayers had made a return and an election of joint filing status. *Mundy*, moreover, is more remarkable for its absence of principle than its revelation of equities. As here, the taxpayer had failed to file income tax returns for several fiscal years; the Commissioner determined deficiencies for those years and sought to collect tax computed at an individual rate though the taxpayer was married. When the taxpayer complained, the Tax Court upheld the Commissioner by this reasoning:

> Under section 51(b)(1), Internal Revenue Code of 1939, a husband and wife may elect to make a "single return jointly." That election must be exercised by the taxpayers at the time the return is filed. Therefore, as Joseph A. Mundy filed no income tax returns for these years the split income provisions were never elected by him. 14 T.C.M. at 1072.

Whatever the validity of this statutory interpretation under the Internal Revenue Code of 1939,[8] Congress has

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[8] Section 51 of the Internal Revenue Code of 1939, 53 Stat. 27 (Feb 10, 1939), contained this truncated version of the present section 6013:

> In the case of a husband and wife living together the income of each (even though one has no gross income) may be included in a single return made by them jointly, in which case the tax shall be computed on the aggregate income, and the liability with respect to the tax shall be joint and several. No joint return may be made if either the husband or wife is a nonresident alien.

since deprived it of force by passing subsection 6013(b). It is no longer true that an election to file jointly "must be exercised by . . . taxpayers at the time the return is filed," and I turn to *Grobart* in search of the equitable considerations to which *Spanos* made reference.

The taxpayer in *Grobart* received in February of 1957 a notice of deficiency from the Commissioner, which computed tax for a number of preceding fiscal years on the basis of individual tax rates. Over two years later, after the taxpayer had gone so far as to have his case docketed in the Tax Court, he and his wife filed joint returns for the years in question. The Tax Court held that the couple was bound by the computation of the Commisioner, citing language from *Grant* v. *Rose*, 24 F.2d 115, 118 (N.D. Ga. 1928):

> "There is nothing in the law to prohibit the choice of joint or separate returns according to the result on the taxes to be paid, although husband and wife actually have kept their affairs entirely separate. On the other hand, *there is nothing in the act to extend the right of choice beyond the time for making the returns.* It is not unreasonable to claim a right to substitute one form of return for the other up to the last day for making returns, but, after that, and especially after the returns have been reviewed and assessments made, there are strong administrative reasons for not permitting the upsetting of the whole basis of calculation. * * * [Italics supplied.]" 20 T.C.M. at 640.

As I have already pointed out in connection with *Mundy*, the passage of subsection 6013(b) has removed the central premise of this argument. Congress has said, in effect, that the "strong administrative reasons for not

permitting the upsetting of the whole basis of calculation'' must give way to a taxpayer's freedom of choice, so long as the taxpayer makes his final election of joint rates within three years of the last legal date for filing his return. That the Commissioner, rather than the taxpayer, has made an initial election of individual tax rates should not, without more, prevent the taxpayer from choosing to be taxed at joint rates; from the Commissioner's point of view, his election is indistinguishable from one which the taxpayer might originally have made for himself. Should the election of the Commissioner stand three years unchallenged, a different case would be presented. Within that three years, however, Congress has suggested that the equities lie with the taxpayer. It seems, furthermore, highly inequitable to accept an argument by the Commissioner directed to his administrative burden of recomputation when, had he simply determined the amount of income upon which tax was due and let the taxpayer make an election of filing status, the burden could have been avoided. In truth, the Commissioner is making an unwanted and expensive election for a taxpayer and thereafter employing that election to assert that its modification would be burdensome to his agency.[9]

The Durovics filed joint income tax returns for the years at issue less than three months after having received a deficiency notice. I doubt that even the *Grobart*

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[9] For this reason, I am not convinced that subsection 6013(b)(2)(C)—which precludes the changeover allowed by subsection 6013(b)(1) when a spouse has been mailed a deficiency notice and has filed a petition in the Tax Court—should be viewed as a Congressional intimation of the equities which pertain to cases where the taxpayer has not initially made an election to be taxed at individual rates.

court—which had faced a two year acceptance by a taxpayer of a Commissioner's election of individual tax rates —would have disallowed those returns. In any event, *Grobart,* and hence *Spanos,* are based on old law, the amendment of which has left them little vitality. I would require the Commissioner to compute the tax owed by the Durovics on the basis of joint rates.

A true Copy:

Teste:

.....

Clerk of the United States Court of Appeals for the Seventh Circuit.

APPENDIX 2

UNITED STATES COURT OF APPEALS

For the Seventh Circuit
Chicago, Illinois 60604

November 26, 1973.

Before

Hon. Luther M. Swygert, Chief Judge
Hon. Latham Castle, Circuit Judge
Hon. Stanley N. Barnes, Circuit Judge

MARKO DUROVIC,

Petitioner-Appellant,

No. 72-1692 vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Appeal from the Tax Court of the United States.

On consideration of the petition for rehearing filed in the above-entitled cause,

It Is Hereby Ordered that the petition for rehearing in the above-entitled appeal be and the same is hereby denied.

Judge Luther M. Swygert voted to grant the petition for rehearing.

APPENDIX 3

[CCH Dec. 30,204] Marko Durovic v. Commissioner. Docket No. 1633-65. 54 TC —, No. 131. Filed June 24, 1970.

[Code Secs. 6012(a) and 6501(c)]

[Limitations: Failure to file individual returns: Partnership returns filed.] 1. *Held,* the good faith filing of a form 1065 partnership return reflecting petitioner's only source of income was not sufficient to start the running of the statute of limitations where petitioner had failed to file an individual return, as required by section 6012(a).

[Code Sec. 61]

[Exchange of foreign currency: Rate of exchange: Official v. commercial rate.] 2. *Held,* petitioner incorrectly used the "official" rate of exchange (as opposed to the "commercial" rate of exchange) in converting the cost of Argentinian expenditures, incurred prior to petitioner's emigration to this country, into dollars.

[Code Sec. 7602]

[Examination of records: IRS denied access to records: Effect on burden of proof.] 3. *Held,* respondent's determination not arbitrary or unreasonable where respondent's agents were denied access to various books and records of a discontinued partnership to which petitioner had belonged, notwithstanding that such refusal was predicated on the presence of a special agent and the attendant possibility that such books and records might have been used against petitioner in a criminal proceeding.

[Code Secs. 704 and 1231]

[Partnership income: Distributive share: Cost of goods sold determined: Treatment of spoilage loss.] 4. *Held,* that in determining petitioner's distributive share of partnership income, respondent erred in disallowing in toto partnership cost of goods sold. (Partnership cost of goods sold determined.) *Held, further,* though not properly includable in partnership cost of goods sold, petitioner's investment in 72,200 ampules of the product Kositerin constituted a section 1231 loss in the year in which such ampules were destroyed as a result of spoilage.

[Code Sec. 6653(b)]

[Additions to tax: Fraud: Fact finding.] 5. *Held,* petitioner did not act fraudulently in failing to pay income tax for each of the years in issue.

[1939 Code Sec. 294 and 1954 Code Sec. 6654]

[Additions to tax: Failure to file declaration of estimated tax: Underpayment of estimated tax: Reasonable cause.] 6. *Held,* reasonable cause existed for petitioner's failure to file a timely declaration of estimated tax during 1954. *Held, further,* additions to tax for underpayment of estimated tax during the years 1955 through 1958 were proper.

[Code Sec. 6013(b)]

[Returns: Election to file joint returns in years when no returns filed: Election subsequent to deficiency determined according to individual rates.] 7. *Held,* petitioner and his wife could not (subsequent to respondent's notice of deficiency) elect to file joint returns for years during which they were married and for which neither filed a return, where respondent had already employed individual taxpayer rates in determining petitioner's deficiency.

No. 73-1239

FEB 21 19

MICHAEL RODAK, JR.

In the Supreme Court of the United States

JANUARY TERM, 1974

MARKO DUROVIC,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

APPENDIX 4

TAX COURT DECISION

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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In the Supreme Court of the United States

JANUARY TERM, 1974

No. 73-1239

MARKO DUROVIC,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

APPENDIX 4

TAX COURT DECISION

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

APPENDIX 4

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54 T. C. No. 131

United States Tax Court

MARKO DUROVIC, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 1633-65. Filed June 24, 1970.

1. *Held,* the good faith filing of a form 1065 partnership return reflecting petitioner's only source of income was not sufficient to start the running of the statute of limitations where petitioner had failed to file an individual return, as required by section 6012 (a).

2. *Held,* petitioner incorrectly used the "official" rate of exchange (as opposed to the "commercial" rate of exchange) in converting the cost of Argentinian expenditures, incurred prior to petitioner's emigration to this country, into dollars.

3. *Held,* respondent's determination not arbitrary or unreasonable where respondent's agents were denied access to various books and records of a discontinued partnership to which petitioner had belonged, notwithstanding that such refusal was predicated on the presence of a special agent and the attendant possibility that such books and records might have been used against petitioner in a criminal proceeding.

4. *Held,* that in determining petitioner's distributive share of partnership income, respondent erred in disallowing in toto partnership cost of goods sold. (Partnership cost of goods sold determined.) *Held, further,* though not properly includable in partnership cost of goods sold, petitioner's investment in 72,200 ampules of the product Kositerin constituted a section

1231 loss in the year in which such ampules were destroyed as a result of spoilage.

5. *Held,* petitioner did not act fraudulently in failing to pay income tax for each of the years in issue.

6. *Held,* reasonable cause existed for petitioner's failure to file a timely declaration of estimated tax during 1954. *Held, further,* additions to tax for underpayment of estimated tax during the years 1955 through 1958 were proper.

7. *Held,* petitioner and his wife could not (subsequent to respondent's notice of deficiency) elect to file joint returns for years during which they were married and for which neither filed a return, where respondent had already employed individual taxpayer rates in determining petitioner's deficiency.

Douglas L. Barnes and *R. Thomas Howell, Jr.,* for the petitioner.

Sheldon Chertow, for the respondent.

IRWIN, *Judge:* Respondent determined deficiencies in petitioner's income tax and additions thereto for the following years:

		Additions to Tax		
Year	Deficiency	6653(b)	6654	294(d) (1) (A) [1]
1954	$27,353.08	$13,676.54	$ —	$2,520.17
1955	55,039.77	27,519.89	1,537.58	—
1956	34,152.29	17,076.15	952.74	—
1957	83,875.51	41,937.76	2,344.54	—
1958	63,926.05	31,963.03	1,785.95	—

[1] Internal Revenue Code of 1939. All other statutory references, unless otherwise specified, are to the Internal Revenue Code of 1954, as amended.

The issues for decision are:

(1) Whether the good faith filing of a Form 1065 partnership return reflecting petitioner's only source of income is sufficient to start the running of the statute of limitations where petitioner has failed to file an individual return, as required by section 6012(a).

(2) Whether petitioner should have used the "commercial" rate of exchange as opposed to the "official" rate of exchange in coverting the cost of Argentinian expenditures, incurred prior to petitioner's emigration to this country, into dollars.

(3) Whether respondent's determination was arbitrary and unreasonable so as to negate the presumption of correctness which normally attaches thereto.

(4) Whether respondent erred in disallowing in toto partnership cost of goods sold and in assessing petitioner with his distributive share of the partnership income generated by such disallowance.

(5) Whether petitioner was fraudulent in failing to pay tax for each of the years in issue.

(6) Whether respondent properly determined additions to tax for failure to file a timely declaration of estimated tax during 1954 and for underpayment of estimated tax during the years 1955 through 1958.

(7) Whether, subsequent to respondent's notice of deficiency, petitioner and his wife may, contrary to respondent's determination, elect to file joint returns for years during which they were married and in which no returns were filed on the mistaken but good faith belief that no tax was due.

FINDINGS OF FACT

Some of the facts have been stipulated by the parties. The stipulation of facts, together with the exhibits attached thereto, are incorporated herein by this reference.

Marko Durovic (hereinafter Marko or petitioner) was a resident of Winnetka, Ill., at the time the petition herein was filed. For each of the years in question Marko lived with his wife, Olga, and their then two minor children. On March 10, 1965, petitioner and his wife filed joint income tax returns for the years 1954 through 1958, inclusive, with the district director of internal revenue at Chicago, Ill.

Marko was born in Ulcinj, Yugoslavia (then Montenegro) in 1900. He was educated at the University of Paris and the University of Belgrade, receiving a law degree from the latter in 1923; whereupon for three years, he served as an assistant to a judge in a district court in Belgrade. Subsequent to his resignation from the judiciary, Marko engaged in the private practice of law. He was also a director and a one-third shareholder of the Vistad Corporation, a company engaged in the large-scale production of armaments and munitions.

Marko practiced law in Yugoslavia until 1941. On April 6, 1941, Yugoslavia was attacked by the Axis powers, and after two weeks of resistance the Yugoslav army capitulated. The northern sector of the country (where petitioner lived) was overrun by the Germans, and the southern sector was occupied by the Italians. Petitioner and his young wife of five days fled to the southern Italian-occupied sector, where they obtained permission to travel to Rome. Marko's first instinct had been to escape through Switzerland where he maintained sizable bank accounts; however, the then position of the German army necessitated the abandonment of this course of action.

Five months after they arrived in Rome, Marko and Olga were joined by petitioner's brother, Dr. Stevan Durovic (hereinafter Stevan). Stevan had been imprisoned in a concentration camp. His release was accomplished through Marko's efforts and in accordance with certain terms of the Geneva Convention relating to imprisoned physicians. During the latter half of 1942, petitioner, his

wife and brother obtained authorization to leave Italy, and with the assistance of the Vatican obtained visas permitting them to emigrate to Argentina, where, in 1942, they established residence.

Stevan had received the degree of Doctor of Medicine in 1930. As early as 1931, Stevan (who was an assistant professor at the University of Belgrade) had conducted extensive research in the field of cancer. It was Stevan's theory that if a proper stimulant for the reticuloendothelial system could be found, the defensive and reparative cells comprising this system could be made to produce a substance which would control malignant growth.

In November 1942 (after arriving in Argentina) Stevan contacted a Dr. Canepa, Dean of the Veterinary Faculty of the University of Buenos Aires and proposed that he (Stevan) be allowed to pursue his research at the University. Stevan was thereafter allowed free use of the University's animal clinic facilities as well as its laboratories.

In researching for the above-described stimulant, Stevan conducted experiments on horses and cattle. Briefly, these experiments consisted of the following steps: First, the experimental stimulant developed by Stevan would be introduced into the animal's system by intravenous injection. About a month later the animal would be bled, the blood serum being extracted by means of an organic solvent such as petroleum ether or benzene. There would then follow a series of steps calculated to dissolve the solvent, evaporate the water content, and separate the insoluble component which, when filtered and contrifugated, would yield a white powder—the active substance. Employing this process, the serum extracted from one horse yielded powder sufficient for only forty 1/100 milligram ampules of the active substance. Most of the horses were supplied free by the University; however, Stevan supplied the eighteen or twenty cattle used in the experiments.

Beginning in 1943, Stevan was assisted in his work by several distinguished scientists, one of whom, Dr. Fabio Damonte (hereinafter Damonte) was a professor at the Veterinary Faculty. Damonte helped inject the animals with the solution prepared by Stevan. Damonte also aided in extracting the blood serum which was then processed by Stevan in his laboratory. This laboratory was established in 1944. In addition to the laboratory, Stevan also maintained a farm in Villa Elisa which he apparently also used for experimentation.

In 1944, still searching for an active substance against malignant tumors, Stevan, using the stimulant *actinobacilus lignieresi,* unexpectedly separated a substance which showed activity against hypertension. This substance was named Kositerin.

At about the time of this discovery, Stevan was being assisted by a fellow scientist, Dr. Carlos de la Serna (hereinafter La Serna). La Serna continued to collaborate with Stevan until the latter's departure for the United States in 1949.

Stevan was very interested in his new discovery, and continued his experiments with the new substance, Kositerin. During this period of time, Stevan was aided financially by a Mrs. Ada Bossard von Martini (hereinafter Ada). Ada was the wealthy daughter of one of the founders of the Nestle Company. She was also an aunt of Marko's wife, Olga. Between 1943 and 1946 Ada advanced a total of 500,000 pesos to Stevan. Sometime thereafter Ada became very ill, and her son, France, was empowered to handle her affairs. In reviewing Ada's papers, France became aware of these advances. Accordingly, he contacted Stevan with a view toward making arrangements for repayment of the debt. Unfortunately, Stevan was not in a position to satisfy this obligation. However, at a subsequent meeting Marko agreed to discharge the sum owing

to Ada. The 500,000 pesos was paid by Marko in 1949. The transaction took place at the Banco Frances Del Rio de la Plata and the medium of exchange was cash.

To permit increased production of the active substance Kositerin, sometime during 1946 Stevan established a laboratory at Las Heras Street in Buenos Aires. Needing funds to finance this operation, Stevan, on May 23, 1946, entered into an agreement with a corporation known as Urbe. Several of Urbe's investors who were interested in Stevan's discovery contributed 172,887.91 pesos to the establishment of a separate division of Urbe which would finance the production of Kositerin. The agreement was, however, cancelled in August 1947 because of the unexpectedly high cost of producing the substance. The persons who had contributed the 172,887.91 pesos were as follows:

Eduardo Gaynor	A$P [2]	62,387.91
Alicia Gaynor de Leslie		70,000.00
Alfredo Goni		23,000.00
Martin Iguerabide		10,000.00
Estela Gaynor		7,500.00
TOTAL	A$P	172,887.91

These amounts were subsequently repaid to the investors by Stevan.

To finance the operations of the production laboratory, which had been named Instituto Biologico Duga (hereinafter Duga Argentina), a new organization, Instituto Biologico Duga, S.A. (hereinafter Duga S.A.), was formed with an initial capitalization of 544,900 pesos contributed in the main by the following persons:

[2] Argentinian pesos designated by the symbol A$P.

German Calvo	A$P	150,000
Asunsion Iglesias Calvo		120,000
Eduardo Gaynor		60,000
Alicia Gaynor de Leslie		70,000
Alfredo Goni		5,000
Martin Iguerabide		10,000
Humberto Lorentani		10,000
Olga Wickerhauser de Durovic		1,000
Stevan Durovic		1,000
Victor Loero		100,000
Estela Lidia Gaynor		7,500
Roberto Amigorena		5,000
	A$P	539,500

Duga S.A. thereafter purchased from Stevan various pieces of scientific equipment and furniture located at Las Heras Street and at Villa Elisa. It also took over the lease on these two properties. In return, Stevan received 168,-708.49 pesos from Duga S.A. which he apparently used in making the 172,887.91 peso payment to the Urbe investors. Stevan also contributed to Duga S.A. raw material sufficient to make 40,000 ampules of Kositerin, for which he was to receive a 70 percent interest in the operations of the business.[3] However, it appears that the raw material was regarded by Stevan and the Duga S.A. investors as a contribution to capital in return for which Stevan would

[3] Because Duga S.A. failed to comply with section 319 of the Argentinian Code of Commerce, which sets forth the procedural prerequisites for incorporation, it never obtained "legal solicitorship"—corporate status. It is, therefore, impossible to ascertain the number of shares to which Stevan (or the other investors) would have been entitled had corporate status been achieved.

be entitled to 70 percent of the net proceeds from the sale of Kositerin. [4]

A comparison of the investors of Duga S.A. with those persons who invested in the Urbe division yields the following table:

	Investment in Duga Department	Investment in Duga as of 8-18-47
Eduardo Gaynor	A$P 62,387.91	A$P 65,400
Alicia Gaynor de Leslie	70,000.00	70,000
Alfredo Goni	23,000.00	5,000
Martin Iguerabide	10,000.00	10,000
Estela Gaynor	7,500.00	7,500
TOTAL	A$P 172,887.91	A$P 157,900

In 1948, Duga S.A. began to experience financial difficulties. As a consequence, Marko was prevailed upon to invest in the company. Marko's investment was in the amount of 255,100 A$P which he paid to Duga S.A. on April 8, 1948.

Under the technical directorship of Dr. Fernando Galmarini (hereinafter Galmarini) Duga Argentina was licensed to manufacture biological products on December 19, 1946. Also a license to sell Kositerin by prescription was issued by the Bureau of Public Health on August 14, 1947.

During this time Argentinian law required that the cost and price of medical products (such as Kositerin) be established by governmental authority. Prior to November 22, 1949, this function was carried out by the Ministry of Pub-

[4] This is evidenced by the fact that, excluding Stevan's 1,000 A$P investment, Duga S.A., with an authorized capital of 1,000,000 A$P (each share being valued at 100 A$P) was already capitalized to the extent of 538,500 A$P at the time the Kositerin raw material was placed at its disposal.

lic Health. However, on this date jurisdiction over this administrative duty passed from the Ministry of Public Health (hereinafter MPH) to the Ministry of Commerce and Industry (hereinafter MCI). MPH's function as a licensor of medical products was not affected by this change in pricing and cost analysis jurisdiction.

In the case of Kositerin, Galmarini, on February 10, 1949, submitted a schedule of costs to MPH. This schedule (made under oath) reflected a raw material cost of 30.05 pesos per two-ampule package of Kositerin and a total product cost of 35.13 per two-ampule package. Among other things, the product cost schedule showed packaging costs of 1.20 pesos per two-ampule package.[5] On March 3, 1949, MPH fixed the selling price of Kositerin per two-ampule package as follows:

Drug Store	58.90 A$P
Pharmacy	67.74 A$P
Public	94.85 A$P

These prices were based upon the schedule of costs submitted by Galmarini.

On August 11, 1949, MPH revoked Duga Argentina's license to sell Kositerin. However, on December 16, 1949, MPH issued a subsequent order reinstating Kositerin and making null and void its earlier resolution revoking Duga Argentina's authorization to sell Kositerin. Excerpts from the resolution, which are herein pertinent, appear as follows:

> That in view of the agreement of the technical reports from the scientific standpoint and the *purely*

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[5] Also included in the 35.13 A$P cost determination were the following items:

waste and breakage	.02 A$P
stamping	.10 A$P
manufacturing costs	.66 A$P
administrative costs	1.85 A$P
royalties	1.25 A$P

administrative bases for the cancellation, a conflict is present between considerations of a scientific nature and others that are merely a metter [sic] of form; [Emphasis supplied.]

* * *

Therefore:

The Minister of Public Health of the Nation Resolves:

Article 1. To declare null and void Resolution No. 19235/49 and the provisions on folio 84, in so far as they pertain to the cancellation of the authorization for the sale of the product called INJECTABLE KOSITERIN.

On January 21, 1950, Marko entered into an agreement with the Duga S.A. investors (other than Olga and Stevan) whereby he agreed to reimburse them for their investment in Duga S.A. Pertinent provisions of that agreement are as follows:

In the City of Buenos Aires, Capital of the Argentine Republic, in the year of the Liberator General San Martin, on the twenty-first day of January, nineteen hundred and fifty, * * * [the investors in Duga S.A.] state as follows:

FIRST: That on July twenty-eighth nineteen hundred and forty-seven they established the bases for the organization of a joint-stock company under the title of "Instituto Biologico Duga Sociedad Anonima Commercial e Industrial" (Duga Biological Institute, Commercial and Industrial Joint-Stock Company), to have as chief purpose the exploitation and manufacture of chemical products, the authorized capital being fixed at the amount of ONE million pesos Argentine currency, in shares of one hundred pesos each. . . .

SECOND: To the effect of obtaining the legal status of the Company, the pertinent steps were taken * * * by virtue of which the Company was allowed to operate as a joint-stock company; not having up to this date fulfilled the requirements of article

three hundred and nineteen of the Code of Commerce, therefore actually the Company has not attained legal corporate existence.

THIRD: That meanwhile, the *partners* had subscribed and invested in cash the following amounts: * * * which * * * in the aggregate * * * total * * * five hundred and thirty-seven thousand five hundred pesos Argentine currency, without taking into account the investment of Mr. Durovic, which was two hundred and fifty-five thousand one hundred pesos, and that of his wife, Mrs. Olga V. de Durovic, which was one thousand pesos. . . .

FOURTH: That the above mentioned persons, in accordance with Mr. Durovic, have resolved to disassociate themselves completely from the corporate activities, letting Mr. Durovic absolutely free to resolve about the future development of the above mentioned Instituto Biologico Duga, Sociedad Anonima, under organization. That for said reason they have resolved to transfer to him all their corporate investments, consisting of the amounts already expressed, and assign to him therefore their shares in the aforesaid Company being organized, as well as all and every right which they might have in it. . . .

FIFTH: That therefore and in accordance with the former statement, Mr. Durovic *pays during this act and in cash,* to each of the aforementioned persons, before me, Notary Public, and witnesses, I attest, the amount of their corporate investments, in the proportion already expressed * * *; the appearers therefore hand over to Mr. Durovic their assignments and letter of payment in due form, adding once more that they transfer to him all the rights and stocks which corresponded to them in the company de facto, as well as those which they could have under the contract signed between them and Dr. Stevan Durovic, and all the rights concerning the elaboration, exploitation and sale of the product called "Kositerin" and they acknowledge that they cannot claim in the future anything from Mr. Durovic, regarding the winding-up of

the corporate business or about the results of the contract with Dr. Stevan Durovic, which any of them personally or on behalf of the Company, might have subscribed. Mr. Marcos Durovic, on his side, states that he accepts the present assignment of shares and rights made by the former stockholders, and he adds that by virtue of same, all the obligations determined in the contract subscribed with Dr. Stevan Durovic remain in his exclusive charge, as well as any obligation pending with Mrs. Olga V. de Durovic, as a member of the Company, the assigners remaining therefore completely released and free from any further claim concerning the matter. *This means practically that the Joint-Stock Company under organization disappears;* and Mr. Marcos Durovic is hereby authorized to take any steps necessary in order to desist before the Executive Power from the obtention of the legal corporate status. * * * [Emphasis supplied.]

Under the direction of Galmarini, Duga Argentina (whose activities had been conducted under the auspices of Duga S.A.) continued to exist after this agreement was executed. Its primary function, however, was that of a storage place for the 72,200 ampules of Kositerin which had been produced as of January 21, 1950. However, as a result of the January 21 agreement, Duga S.A. no longer operated in its former capacity.

During 1949, studies on the effectiveness of Kositerin were conducted by the School of Medicine at Northwestern University in Illinois. The results of these tests were found to be uncertain. It was apparently this fact which had led to the dissolution of Duga S.A. No Kositerin was ever sold in Argentina. However, in November 1953 a petition was filed with MCI requesting a revised cost schedule reflecting post-1949 storage and administrative costs associated with Kositerin. The reply from MCI, dated January 8, 1954, contained the following pertinent language:

In reference thereto, I must state that pursuant to category "A" in which said drug has been classified

by the Ministry of Public Health of the Nation (authorization certificate No. 15899) and bearing in mind the provisions in Article 1 of Resolution MIC No. 753/50, you may launch the sale of said product, which prices shall be verified and definitely fixed at the proper time.

For this purpose, you must after sixty (60) days file in duplicate the justifying factors as to cost in a clear and faithful manner with Department No. 1 (Costs and Prices). The nonperformance of this requirement shall automatically render this authority null and void after one hundred and eighty (180) days from this date.

No indication exists as to whether Galmarini provided MCI with the "justifying factors" as stated above.

Early in 1956, MPH informed Galmarini that all 72,200 ampules of Kositerin would have to be destroyed as a result of spoilage. The destruction of the product was accomplished on February 17, 1956. Marko, who resided in Illinois at this time, returned to Argentina to witness this event. At this time, Duga Argentina was closed, and Marko instructed Ernesto Romagnese, an office employee in charge of commercial books and correspondence to collect all of Marko's commercial papers still in Argentina and mail them to the United States. Alejandro Stefanovic, an old friend of Marko's, supervised the collection and packing of these items. Two parcels were shipped to Marko; however, only the parcel containing certain of Marko's personal effects reached the United States. At the insistence of Stefanovic, an investigation was conducted by the Argentinian authorities; however, the parcel containing Marko's commercial documents was never found.

Following the discovery of Kositerin, Stevan continued research in the area of cancer. Experimenting with different stimulants, in 1947 Stevan came upon a substance derived from the blood serum of horses which had been stim-

ulated by a fungus called *actinomyces bovis.* The method of preparing and extracting this substance was identical in all respects to the procedure used in obtaining Kositerin, the only difference being that in obtaining the new substance the stimulant used was *actinomyces bovis,* instead of *actinobacilus lignieris.* The new substance was referred to as "drug X" (later to be called Krebiozen). During 1947 and 1948, Stevan tested this substance on naturally occurring tumors in dogs and cats. Convinced that the substance possessed properties which made it active against malignant tumors, Stevan related his findings to certain members of the Buenos Aires scientific community. Stevan was assisted in his research by de la Serna and Galmarini.

In March 1949 Stevan left Argentina and traveled to the United States on a temporary visa. In May 1949 Olga (who spoke English) left Argentina to serve as aide and interpreter to Stevan, who was at this time disclosing his findings to several prominent scientists in the United States. She also traveled on a temporary visa.

While in Argentina Stevan's research with drug X had been financed by Juan Manuel Tanoira (hereinafter Tanoira), an industrialist and entrepreneur. By contract dated August 1947 Tanoira, in consideration for a one-half interest in any returns from the sale of drug X, had agreed to finance the development and production of this drug. During the years 1947, 1948 and 1949, Tanoira expended a total of about 3,000,000 pesos on this project. During this time enough drug X (2 grams, 35 centigrams) had been produced to make 200,000 ampules of the product. However, with the departure of Stevan for the United States, Tanoira lost interest in the arrangement, and in the autumn of 1949 contacted Marko with a view toward having the latter recompense Tanoira for his investment.

Discussions relating to the liquidation of Tanoira's investment took place over a period of several months.

Tanoira and petitioner differed on the amount of Tanoira's investment. However, since the preparation and extraction process used to obtain drug X was identical to the method used to obtain Kositerin, petitioner offered to pay Tanoira an amount (3,005,000 pesos) which would reflect the preparation and extraction cost (15.025 A$P) of one ampule of Kositerin, as determined by MPH on March 3, 1949, multiplied by the number of ampules (200,000) which could be manufactured from the 2 grams, 35 centigrams of drug X which had been produced by Stevan.

During these negotiations, Tanoira hired a public accountant, David Muchenik (hereinafter Muchenik) to make a detailed audit of all the expenses which had been incurred by Tanoira in the development of drug X. Muchenik's report, which included certain prefatory language quoted below, revealed a cumulative expenditure of 2,997,500 A$P:

> The documentation supplied to the undersigned (Muchenik) was the following:
> 1 inventory book, unmarked, 200 pages.
> 1 daybook, unmarked, 200 pages.
> 1 cashbook, unmarked, 400 pages.
> 1 book of entrances and expenditures of drugs, 200 pages.
> 7 folders with various documentation.
> 6 folders containing contracts, invoices and receipts.
> Although the books were unmarked, they were prepared according to valid accounting methods, with double entries, and no deficiencies were observed in their preparation.
> The undersigned obtained samples of the accounting and compared it with the documentation provided, observing that both coincided, therefore considering it authentic because it was basked by—adequate documentation.

On the basis of this audit (which covered the period beginning on January 1, 1948, and ending on December 10, 1949, and which reflected losses and gains incurred in

the disposition of all items and livestock used in the development and production of drug X), and in accordance with Marko's prior offer, the two parties entered into the following agreement dated January 26, 1950:

> Mr. JUAN MANUEL TANOIRA, an argentine [*sic*] citizen, married, residing at Montevideo 1520, Federal Capital, on the one hand, and Mr. MARCO DUROVIC, residing at Arenales 2120, Capital, on the other, both of legal age and able to enter into contracts, decide the following:
>
> FIRST: Mr. Juan Manuel Tanoira, on the 25th day of August 1947, signed a contract with Dr. Stevan Durovic to finance the production and exploitation of a discovery made by Dr. Durovic, consisting of a drug for the treatment of malignant tumors, to which no name has yet been given, which will henceforth be called DRUG X.
>
> SECOND: The contract provides for a participation in the utilities, in equal parts on a fifty/fifty basis.
>
> THIRD: During the years 1947, 1948, and 1949, Mr. Tanoira financed the production of Drug X, of which a net quantity of two grams, thirty-five centigrams of powder have been produced, with a capacity to produce two hundred thousand doses, dissolved in two hundred thousand ampules of one cubic centimeters each.
>
> FOURTH: During the second part of March, 1949, Doctor Durovic left for the United States of America with the object of experimenting with said drug in the scientific centers.
>
> FIFTH: As Mr. Tanoira has lost interest in the venture and is no longer willing to continue financing the drug in the future, he has agreed to transfer to Mr. Marko Durovic, for the sum of three million five thousand Argentine pesos, all his rights and shares, *as well as the total quantity of the product,* which consisted of two grams thirty-five centigrams of powder, sufficient to produce about two-hundred thousand doses of 'Drug X", * * * [Emphasis supplied.]
>
> SIXTH: The payment of the price and the delivery of the drug simultaneously, *with the present act serv-*

ing as sufficient receipt and reciprocal letter of payment, with Mr. Tanoira handing over to Mr. Durovic all the documentation he possesses, as well as a copy of his contract with Dr. Stevan Durovic, stating that hereafter he has no right to claim anything whatsoever. [Emphasis supplied.]

SEVENTH: The parties make it a matter of record that this agreement is authorized by Dr. Stevan Durovic, according to his letter dated January 19, 1950, addressed to Mr. Tanoira, which reads: "January 19th, 1950, Winnetka, Dear Mr. Tanoira: I received your letter which I am now answering. My brother Marko had informed me before of talks held with you, as to your desire to withdraw from the partnership in the exploitation of the drug for the treatment of malignant tumors. Understanding your situation and your difficulties, *I agree that you transfer everything to my brother Marko Durovic,* and I hereby authorize this transaction.—Yours sincerely, Doctor Durovic." [Emphasis supplied.]

Of the 3,005,000 pesos paid to Tanoira, 2,000,000 A$P had been borrowed by Marko from the banking house of Armando Ferrari.

In accordance with the terms specified above, Marko took possession of the 2 grams, 35 centigrams of drug X which Tanoira had been keeping as security. It was the intention of Marko and Stevan that, as of the date of the above agreement, the ampules to be derived from the drug X substance would be the subject matter of a partnership (for the distribution and sale of drug X in the United States) in which each would have a 50 percent interest. Soon, thereafter, Marko left for the United States bringing with him the entire supply of drug X. Drug X (or Kreboizen) was never licensed in Argentina.

After arriving in the United States, Stevan was put in contact with Dr. Roscoe Miller (hereinafter Miller) of the medical school at Northwestern University. Miller supervised the study of Kositerin which, as indicated earlier, yielded uncertain results. As a consequence, during July 1949, Miller referred Stevan to Dr. Andrew C. Ivy (hereinafter Ivy), then vice-president and head of the Department of Clinical Science of the University of Illinois. Though Kositerin was the intended topic of concern, Ivy's interest in the drug abated quickly with Stevan's disclosure of his work on drug X. This was attributable to the fact that Stevan's research with substances active against malignant tumors was quite similar to research conducted by Ivy as far back as 1917.

Sometime prior to April 1951 and subsequent to his arrival in the United States, Stevan established a laboratory at West Adams Street, Chicago, for the production and distribution of drug X. In addition, further research on drug X was conducted at this building by Stevan, Ivy and a Dr. Reginald Rabadan. During this time, 200,000 ampules of medicine were derived from the 2 grams, 35 centigrams of available drug X raw material. Ivy, Stevan and one of Ivy's assistants tested the drug for toxicity by taking it themselves. Convinced that the drug was nontoxic, Stevan and Ivy made it available free of charge on an experimental basis to physicians whose patients were suffering from advanced or terminal cancer. Detailed diagnostic forms were also supplied to these physicians who were requested to summarize their observations and return the completed forms to Ivy. Ivy was in charge of collating these forms and appraising the results which they reflected. Between 1950 and 1959, approximately 3,000 physicians administered the drug to over 4,000 patients.

In April 1951 a nonprofit organization called the Krebiozen Research Foundation (hereinafter Foundation) was formed. Under the supervision of Ivy, the purpose of the

Foundation was to conduct experiments on drug X (now called Krebiozen)[6] and to authorize, oversee and coordinate the experimentation being conducted by the many physicians who had requested its use. No charge to participating physicians or patients was made for this service, the costs of which were defrayed by Marko and Stevan.

In September 1951 the West Adams Street Laboratory was registered under the name Duga Biological Institutes. On April 5, 1954, the name was changed to Duga Laboratories (hereinafter Duga Illinois). Operated as an equal partnership between Stevan and Marko, Duga Illinois was responsible for the distribution of Krebiozen recommended by the Foundation. Duga Illinois, now operating as a formal business unit, was the outgrowth of the partnership relationship occasioned by Marko's purchase of the active substance, drug X, from Tanoira early in 1950. Prior to April 1954 no charge was made by Duga Illinois for any of the distributed ampules. All costs during this period were paid by the partners.

In the spring of 1951 petitioner and his brother were referred to an attorney, a Mr. Homer L. Bruce of Houston, Tex., for advisory work in connection with possible tax problems relating to the operation of the Foundation and distribution of the drug. On April 23, 1951, a letter signed by Ivy as president of the Krebiozen Research Foundation was sent to the Internal Revenue Service requesting (1) a ruling classifying the Foundation as a tax-exempt organization, and (2) a ruling establishing the cost of the 200,000 ampules of Krebiozen at $1,326,000. Also requested was a determination that no taxable income would be realized by the Durovics should they decide to sell the 200,000 ampules of Krebiozen to the Foundation for $1,326,000.

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[6] Unless otherwise indicated, drug X will hereinafter be referred to as Krebiozen.

The cost figures of $1,326,000 had been arrived at pursuant to consultation with petitioner's financial advisors and attorneys. Because Kositerin had been an innocent by-product of Stevan's search for a substance active against malignant tumors and because the preparation costs and extraction costs of Kositerin were identical to those incurred in producing Krebiozen,[7] petitioner believed that the stated figure should be one which reflected the basic cost of producing the 200,000 ampules of Krebiozen as well as the 72,200 ampules of Kositerin (as determined by MPH on March 3, 1949), increased by the various distribution costs incurred by petitioner and his brother since arriving in the United States. The following schedule summarizes the above cost computation:

Kositerin—72,200 units at 17.565 (based upon a two ampule "total product" cost of 35.13 A$P)	=A$P	1,268,193
Krebiozen—200,000 units at 15.025 (based upon a two ampule raw material cost of 30.05 A$P)	=A$P	3,005,000
	A$P	4,273,193
Additional Argentine expenses (not explained)	A$P	6,800
Total (rounded to nearest 100 A$P)	A$P	4,280,000
Converted into dollars $1 U.S. = A$P 3.36)[8]		$1,273,809.50
Additional U.S. expenses: 1949 to April 1951.		52,202.15
Total costs to nearest $100		$1,326,000.00

[7] Packaging costs did differ.

[8] To obtain the conversion rate used above, petitioner wrote to the First National Bank of Chicago and was informed that prior to August 29, 1950, Argentinian costs were to be converted at the "official" rate of 3.36 A$P to $1 U.S.

On May 9, 1951, the Internal Revenue Service issued a reply letter in response to the requested rulings. Pertinent portions of that letter appear below:

> In order that this office may be in a position to determine whether the requests for rulings and final closing agreement may be granted, additional information, as indicated hereinafter, is essential.
>
> From the facts presented, it is evident that there are two distinct classifications of property involved: One, the secret formula with reference to which Krebiozen is produced; the other, the product Krebiozen itself. It appears that there is no immediate desire to establish the nature nor the value of the formula itself for income tax purposes, but only that of the manufactured product, which now consists of 200,000 units.
>
> It is stated that the Durovics have expended all of their personal resources in the manufacture of this supply. Although the total cost which they attribute to the 200,000 units is $1,326,000.00, a considerable additional, but unidentified, sum is indicated to have been spent in research in connection with the project.
>
> In view of these circumstances, it is necessary that the specific elements or factors involved in the development of the formula, and the resulting product Krebiozen, together with their respective costs, be furnished in such reasonable detail as will permit of eventual field verification. In other words, for what particular purposes and in what corresponding amounts were the various capital outlays incurred to perfect the formula, and to accomplish production of the actual units of Krebiozen identifying, if any, amounts attributable strictly to the value of the Durovics' time and labor?

On May 31, 1951, Ivy, writing on behalf of the Institute, informed the Internal Revenue Service that the requested

rulings were being withdrawn. The reasons for Ivy's action in withdrawing the ruling requests are summarized in a subsequent ruling request, the pertinent provisions of which appear below:

> In reference to the items of cost to the Durovics of the 200,000 ampules they propose to sell to us, we hand you copy of letter agreement between them and us of even date with this letter under which they agree to enter into a contract for the sale of said ampules to us and we agree to purchase them, and we hand you copy of the proposed contract referred to in that letter agreement. From the letter agreement[9] you will see

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[9] Their letter agreement, dated May 31, 1951, contained the following pertinent language:

Chicago, Illinois
May 31, 1951

Krebiozen Research Foundation,
Chicago, Illinois.

* * *

Our said supply of Krebiozen was produced in Argentina and all of our recœcords of the costs incurred by us in Argentina in its production are in that country. For us to get those records into the United States in order that we might substantiate in detail our said cost, it would be necessary for one of us to go to Argentina to get them. However, as you know, we were admitted to the United States on only temporary permits and we have no way of knowing whether, if either of us should return to Argentina, we would be allowed to depart from Argentina or be allowed to re-enter the United States. Under these circumstances it is not feasible for either of us to go to Argentina and therefore at this time it is impossible for us to supply the Commissioner of Internal Revenue with the evidence of these costs requested by him.

* * *

Yours very truly,
/s/ *Dr. Stevan Durovic*
Dr. Stevan Durovic
/s/ *Marco Durovic*
Marco Durovic

> that *most of their records in reference to the cost of the 200,000 ampules are in Argentina and owing to their passport and permit status, they cannot go to Argentina now to obtain those records.* They are therefore willing to make said sale to us, as shown by their letter agreement with us, if we or they can obtain from you a ruling or closing agreement under Section 3760 of the Internal Revenue Code that those ampules are in their hands capital assets and any profit that they might be held to have made on the sale will be treated as a long term capital gain. * * * [Emphasis supplied.]

This second ruling request was also withdrawn at a later time. The sale of the Krebiozen ampules to the Institute was never consummated.

Meanwhile, the drug continued to be distributed *gratis* on an experimental basis. Petitioner's efforts, early in 1954, to obtain a license to sell Krebiozen under prescription were not successful, for a storm of huge proportions regarding the medical efficacy of the drug, Krebiozen, had begun to rage. Nevertheless, free distribution on an experimental basis continued up to April 1954. At this time, Marko and Stevan had exhausted all their resources and, without financial assistance, could no longer underwrite the activities of either the foundation or the laboratory. Accordingly, it was decided to solicit payment from the patients to whom the drug was being administered. To implement this decision, Ivy assisted by James Griffin, attorney to petitioner, drafted a form letter which was circulated to all physicians interested in using Krebiozen. The letter advised that: (a) Krebiozen was an experimental drug available to physicians for clinical investigation purposes to be used in accordance with the rules and regulations of the Federal Food and Drug Administration under the supervision of the Krebiozen Research Foundation; (b) Krebiozen would be supplied by Duga Laboratories upon the instruction of the foundation at a product cost of $9.50

per ampule; but (c) if the patient were unable to contribute the full cost, the judgment of the physician and patient would determine the contribution to be made for each ampule of the product; and (d) if the patient could not pay anything, Duga Illinois would consider such a case for a charitable distribution. Little indication exists as to how the Institute or Duga Illinois arrived at the $9.50 production cost figure; however, the genesis of the figure seems to be related to the number of ampules (136,097) on hand at the beginning of April 1954 spread over costs computed to that time.

During the years 1954 through 1958 the following net amounts were received by Duga Illinois as payment for distributed Krebiozen:

1954	$149,694.10
1955	205,936.73
1956	171,926.98
1957	263,336.53
1958	217,213.36

These amounts were reported as "Gross receipts from business" on partnership returns timely filed by Duga Illinois for each of the years indicated. Offsetting these amounts on the respective partnership income returns for each of the years in question were the following cost figures shown on the returns as cost of goods sold in each of the years indicated:

1954	$172,957.74
1955	319,682.64
1956	244,738.80
1957	344,244.24
1958	251,611.92

The cost of goods sold for the year 1954 was based upon the following computation:

Original supply of Krebiozen		200,000 ampules
Less, amount distributed without charge or withheld for experimental programs, 1949 to April 1954		63,903
Balance on hand		136,097 ampules
Cost computation: $1,326,000[10] ÷ 136,097 = $9.74 per ampule. 17,752 ampules distributed at $9.74 =	$172,904.48	
Cost of goods sold per return	$172,957.74	

This method of arriving at cost of goods sold had been advised by petitioner's attorney, James Griffin, who felt that it would be proper to total all the costs incurred by the Durovics since Stevan began his research in Argentina, and amortize this sum over the number of Krebiozen ampules on hand at the time (April 1954) payments were first solicited. Griffin also urged petitioner and his brother to secure the services of a qualified accountant to assist them in the preparation of their partnership income tax returns and to supervise their record keeping system. Accordingly, petitioner obtained the services of Harry Grauer (hereinafter Grauer), a certified public accountant. Grauer also advised Marko that total Argentinian and U.S. costs should be amortized over the number of ampules on hand in April 1954.

Relying upon Argentinian cost figures supplied by Marko and United States cost figures reflected in records which had been maintained by Olga, Grauer arrived at the 1954 cost-of-goods-sold figure shown above. However, in

[10] See App. page 69 for the manner in which this dollar amout was determined.

so doing, Grauer omitted to take into consideration United States expenditures claimed to have been incurred between May 1951 and April 1954, and reflected in Olga's books in the amount of $78,511.33.[11] This amount when combined with the $1,326,000 cost figure yielded a combined cost of $1,404,511.33.

Accordingly, for the years 1955 through 1958, cost of goods sold on the partnership returns was computed to re-

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[11] Commencing with Marko's arrival in the United States early in 1950, Olga had assumed responsibility for collecting bills and maintaining a record of daily partnership expenditures. These records and supporting documents were maintained in a chronological file without reference to category or classification. However, in 1955, Grauer instructed Olga to consolidate her records and categorize the various expenditures into appropriate classifications. Accordingly, Olga prepared an expense journal in which all expenditures incurred by Marko and Stevan subsequent to October 1949 and prior to April 1954 were recorded. In this journal personal expenditures were denoted as same and ultimately separated from the summary of business expenditures.

For the period ending April 1951, non-personal expenses totaled $52,202.15, and for the period commencing May 1951 and ending March 1954, non-personal expenses totaled $78,511.33. However, included in these totals were expenditures attributable to food, travel and lodging incurred by the Durovics prior to July 1952 and treated by Olga as temporary living costs while away from Argentina. (Prior to July 1952, the Durovics were residents of the United States only by virtue of their temporary visas. By act of Congress, permanent residency in this country was granted to them on June 16, 1952.) These items amounted to $10,203.56 prior to May 1951, and $10,749.88 for that part of the subsequent period ending in July 1952. Additionally, $4,372.66 of the non-personal expenditures, though paid by the Durovics, were attributable to the Institute and not the partnership.

flect a per ampule cost of $10.32[12] which was obtained by dividing the April 1954 quantity of ampules (136,097) into the adjusted total cost figure of $1,404,511.33. The 1954 return was not amended. In 1959, the Internal Revenue Service examined Duga Illinois' 1957 partnership return. The purpose of the audit was to examine the propriety of the change in per ampule cost which had been initiated in 1955. At the conclusion of the audit, the district director issued a "no change" report dated July 7, 1959, the body of which appears below:

Duga Laboratories
343 S. Dearborn Street
Chicago, Illinois

In re: Form 1065
Year 1957

Gentlemen:

Our recent examination of the above-noted partnership return for the year indicated discloses that no change is necessary with respect to the information contained therein. Accordingly, the return will be accepted as filed.

Very truly yours,

/s/ Harold R. All
District Director

In light of the large losses shown on the partnership returns for the years 1954 through 1958, Grauer advised

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[12] Employment of this per ampule cost yields the following cost-of-goods-sold figure for years 1955 through 1957:

1955	$316,555.68	($319,682.64)
1956	244,924.56	(244,738.80)
1957	348,011.04	(344,244.24)

The cost of goods sold actually claimed in each of these years (see App. page 73, *supra*) is depicted above parenthetically. The record does not reveal the reason for these discrepancies. Since neither party has alluded to these discrepancies on brief, and since, in the aggregate they are *de minimis* we will not belabor the matter.

Marko and Stevan that they would not have to file personal income tax returns for these years. Except for interest on a joint savings account (equalling $680 in 1957 and $891.28 in 1958) Marko and Olga had no other income during the years 1954 through 1958.

On September 9, 1963, a preliminary investigation of Marko Durovic, Stevan Durovic, Duga Illinois and Promak Laboratories (successor to Duga Illinois and operated exclusively by Stevan subsequent to the disbandment of Duga Illinois in 1959) was initiated by revenue agent Sanford Schwartz (hereinafter Schwartz) and by special agent William Mannie (hereinafter Mannie) of the intelligence division of the Internal Revenue Service. Agents Mannie and Schwartz were primarily concerned with losses reported by Duga Illinois which had been carried forward by Stevan on his 1961 personal income tax return.

An appointment was made with Stevan to review certain Duga Illinois records relating to Stevan's 1961 return and which were maintained at Promak Laboratories (hereinafter Promak). On December 26, 1963, agents Mannie and Schwartz visited Promak; however, because a special agent was investigating the case, and, on the advice of Stevan's legal counsel, the desired information was not made available to them. Similar requests for these records were made at subsequent meetings between Stevan's counsel and agents Mannie and Schwartz. However, as long as special agent Mannie remained on the case, Stevan's legal advisors continued to withhold the requested records. Finally, in July 1964, both agents contacted accountant Grauer and from him obtained a complete set of the work papers used in the preparation of the Duga Illinois partnership returns. Also, at about this time, agents Mannie and Schwartz were informed that neither Stevan nor Marko had filed individual tax returns for the years 1954 through 1958.

On October 28, 1964, Marko Durovic, Dr. Stevan Durovic and the Krebiozen Research Foundation were indicted by suppressed indictment for introducing mislabeled drugs into interstate commerce in violation of the Food, Drug and Cosmetic Act. A bond of $500,000 was requested by the district attorney for each defendant, alleged by petitioner to be the highest bond ever exacted in the history of the United States. On the same day, October 28, 1964, the Internal Revenue Service made a jeopardy assessment against Marko in the amount of $519,063.05 and levied on all the real estate and other assets owned by petitioner and his wife Olga. The next day petitioner and his brother appeared in Federal District Court in Chicago before Judge Joseph Sam Perry. Present at this hearing were agents Mannie and Schwartz. Judge Perry withdrew the bond and released Marko and Stevan on their own recognizance. The jeopardy assessment was, however, neither abated nor reduced in amount and still remains extant. More than 15 months later the petitioner, his brother and all the other defendants were acquitted of all charges related to the Federal indictment after nine months of trial.

At no time prior to the jeopardy assessment was petitioner ever contacted by either agent Mannie or agent Schwartz, notwithstanding that the records and returns obtained from Grauer revealed that Marko was a partner in Duga Illinois. Petitioner's attorney, Douglas L. Barnes, was contacted during November 1964; however, since a special agent was still on the case, once again no information was disclosed to the agents. It appears that respondent was unsuccessful in reaching Marko at this time.

On December 28, 1964, a statutory notice of deficiency, containing the determination set forth earlier, was issued to petitioner. The determination contained therein was in all respects identical to the revenue agent's examination reports filed by agent Schwartz on November 20, 1964, in

which cost of goods sold reported by Duga Illinois for each of the years 1954 through 1958 had been denied in toto with the resultant income being taxed to petitioner and his brother. This report was prepared without either agent ever having had the benefit of any of the Duga Illinois records unsuccessfully sought from Stevan and, later, from Marko's attorney.

In his report, agent Schwartz computed Marko's taxable income on the basis of a married taxpayer filing an individual return. Accordingly, individual, as opposed to joint, income tax rates were employed in determining Marko's deficiency. Similarly, a standard deduction of only $500 was also allowed to Marko. Nevertheless, as stated earlier, Marko and Olga (who had not previously filed a return for any of the years in question) on March 10, 1965, filed late joint income tax returns for each of the years 1954 through 1958.

OPINION

In 1942, petitioner Marko and his brother, Stevan, emigrated from Europe to Argentina. Stevan was a doctor of medicine and a research scientist. His research had been in the field of cancer. Upon his arrival in South America Stevan contacted various persons in the Argentinian scientific community with a view toward resuming his research work. With financial backing from a relative of Marko's wife, Stevan was able to resume his search for a stimulant active against cancer.

While searching for this stimulant, Stevan, in 1944, unexpectedly discovered a substance (Kositerin) which showed activity against hypertension. During the next twelve years substantial sums were spent in the development and production of this substance. Most of these expenditures were initially defrayed or ultimately absorbed by Marko. The product was destroyed in 1956 due to spoilage. It was then owned by Marko.

In 1947, Stevan's research produced a second substance (Krebiozen) which showed activity against malignant tumors. With financing from Argentinian entrepreneur, Juan Tanoira, Stevan was able to produce enough of this substance for 200,000 ampules of the drug Krebiozen. In 1949, Stevan left Argentina for the United States. The Krebiozen raw material was later brought to the United States by Marko, who had purchased the raw material from Tanoira. Together the brothers, with the assistance of several U.S. scientists, undertook to make the drug available, on an experimental basis, to physicians caring for patients with advanced cancer.

Distribution of the drug was accomplished by a partnership made up of Stevan and Marko. Only after Marko and Stevan had depleted their financial resources did the partnership, in 1954, request payment for ampules of Krebiozen being distributed. The correctness of the cost of goods sold attributed to these ampules and shown on the partnership information returns for each of the years in issue is the central question in this case. However, before reaching this question, we must first consider several preliminary issues raised by the parties.

Issue 1: Statute of Limitations

Section 6501(a) states the general rule that assessment of taxes shall be made within three years after the return in question was filed. Two exceptions to this rule are found in sections 6501(c)(1) and 6501(c)(3), which state, respectively, that assessment may be made at any time where a return has either been fraudulently filed or not filed at all.

In the instant case, petitioner, citing section 6501(a), contends that respondent's notice of deficiency (bearing a December 28, 1964, date) was not timely as to the years (1954 through 1958) now before this Court. Respondent disputes this contention, claiming in the alternative that,

(a) for purposes of section 6501(c)(3), the partnership returns of information filed by Duga Illinois cannot be treated as petitioner's personal tax returns; and, (b) even if such treatment were proper, section 6501(c) would still permit assessment, it being respondent's alternate position that the partnership returns which were filed were false and fraudulent.

Since we agree with respondent's first argument, we need not consider the question of whether the returns filed on behalf of Duga Illinois were tainted with fraud.

Partnerships, under our system of taxation, are accorded a unique status. Rather than the partnership being held taxable for income generated by its activities, it is the individual partner who is liable for tax on his distributive share of partnership earnings. Section 701. Notwithstanding this peculiarity, section 6031 directs that every partnership file an annual return setting forth, *inter alia*, the items of its gross income and deductions and the names and distributive shares of its members. This provision, for purposes herein pertinent, must be contrasted with section 6012(a) which requires that every *individual* having a gross income of $600[13] or more must file a return with respect to income tax. Given this statutory framework, the specific question we must now face is whether, in the absence of an individual tax return, the good faith filing of a form 1065 partnership return satisfies the requirements of sections 6012(a) and 6501(c)(3) where such partnership return is (1) complete on its face, and (2) discloses the only source of income of the individual partner in question. As stated above, we believe this question must be answered in the negative.

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[13] For purposes of this discussion, and, as will be established at a later point in our opinion, Marko's gross income for each of the years in question is assumed to be in excess of $600.

In support of his position, petitioner cites several cases which have considered the status to be accorded form 1065 partnership returns within the context of section 6501(e)(1)(A)(ii).[14] See, e.g., *Jack Rose,* 24 T.C. 755 (1955); *Nadine I. Davenport,* 48 T.C. 921 (1967); *Genevieve B. Walker,* 46 T.C. 630 1966); and *Elliott J. Roschuni,* 44 T.C. 80 (1965), which extended the reach of subparagraph (ii) to form 1120-S information returns.[15] In each of these cases the question considered was whether information omitted on the taxpayer's individual return, but disclosed on the partnership return could be used to satisfy the ameliorating language of subparagraph (ii)

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[14] SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

* * *

(e) Substantial Omission of Items.—Except as otherwise provided in subsection (c)—

(1) Income taxes.—In the case of any tax imposed by subtitle A—

(A) General rule.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph—

* * *

(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item.

[15] Where a corporation elects to conduct its business as a "tax-option" corporation, it is not liable for any of the regular corporate income taxes and does not have to file a form 1120 corporate reture. However, it is required under sec. 6037 of the Code to file an information return on form 1120-S.

of section 6501(e)(1)(A);[16] and in each instance the Court agreed that the partnership return

> should be taken into consideration in determining whether any omitted amount was disclosed in the [partnership] return in a manner adequate to apprise [respondent] of the nature and amount of such item. [*Genevieve B. Walker, supra,* at pp. 637-638.]

See also, Rev. Rul. 55-415, 1955-1 C.B. 412.

Though we do not in any way reject the reasoning of the cases cited by petitioner, we do not feel they are apposite to the question at hand. The rationale underlying these cases was that respondent would not be at a disadvantage to detect errors, as envisioned by section 6501(e)(1)(A), see *Colony, Inc.* v. *Commissioner,* 357 U.S. 28, 36 (1958), where the taxpayer's individual return, as augmented by a form 1065 return, was sufficient to furnish respondent with adequate "clues" as to the nature and amount of items omitted from the individual return but disclosed in the partnership return. *Benderoff* v. *United States,* 398 F. 2d 132 (C.A. 8, 1968); and *Elliott J. Roschuni, supra.*

The cases in this area did not have to consider the question of whether, for purposes of sections 6012(a) and 6501(c)(3), a partnership return may be accorded the status of a partner's individual return. Even so, since the filing of a partnership return, without more, places respondent at an obvious disadvantage as to non-partnership items of income (such as interest, dividends and capital gain) which are shown only on the partner's individual

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[16] Pursuant to section 6501(e)(A), the statute of limitations for assessment of tax is extended to six years if the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return. Under subparagraph (ii) thereof, the computation of the "amount * * * omitted from gross income" excludes amounts disclosed in the return.

return, we believe petitioner's argument must be rejected under the very same rationale employed by those cases which he looks to for support. [17]

For reasons similar to those expressed above, we also hold that petitioner's reliance on the "wrong return" cases of *Germantown Trust Co.* v. *Commissioner,* 309 U.S. 304 (1940), and *California Thoroughbred Breeders Association,* 47 T.C. 335 (1966), is also misplaced.

In *Germantown,* taxpayer trust company, on March 15, 1933, filed a form 1041 fiduciary return for the years 1932, in which it accurately set forth its gross income, deductions, net income, and the respective beneficiaries' shares. All of the beneficiaries included their shares in their individual returns. At a later time it was held that the trust should have been taxed as a corporation. Accordingly, the respondent prepared the appropriate corporation return and, after more than two years had expired, gave notice of a tax deficiency.

Under section 275(c) of the then Revenue Act of 1932, an exception to the normal two-year statute of limitations arose if a corporation made no return of tax. Under this exception corporate tax could be assessed within four years after the date on which any shareholder filed his return. The issue in *Germantown* was whether the form 1041 filed by the "trust" constituted a tax return for purposes of the statute of limitations.

Relying in part on the fact that the incorrect return filed by the "trust" contained all the data from which a tax could be computed and assessed, the Supreme Court held that the filing of the form 1041 by a fiduciary in good faith commenced the running of the statute of limitations

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[17] See also sec. 301.6501(e)-(1)(c), Income Tax Regs., which provides that section 6501(e)(1) does not limit the application of section 6501(c).

for assessment of corporate income tax, and that assessment was, therefore, barred. Compare *Commissioner* v. *Lane-Wells Co.*, 321 U.S. 219 (1944), where it was held that the filing in good faith of a form 1120 corporate income tax return, in which the corporation denied it was a personal holding company, was not sufficient to start the running of the limitation period for personal holding company surtax (which should have been computed on form 1120H).[18]

In the case of a partnership return filed without more, respondent is not benefitted by all the data needed to compute the nonfiling partner's individual tax liability since, even if such partner did not, in fact, realize additional nonpartnership income, there is no way to ascertain this fact absent an individual return. Hence, we are not influenced by the result reached in *Germantown.* Nor is our conclusion altered in any way by the following language from our opinion in *West Coast Ice Company,* 49 T.C. 345, 349-350 (1968):

> In *Lane-Wells* the Supreme Court distinguished its decision in *Germantown Trust Co.* v. *Commissioner,* 309 U.S. 304 (1940), not, as petitioner claims, upon the ground that the return filed in *Germantown Trust* contained all the information required in the return which should have been filed, but because:
>
> > There [*Germantown Trust*] the only liability involved was for a Title I income tax, and the return was addressed to that liability, as to which the court held that it set the statute of limitations running. Here the taxpayer is under liabilities for two taxes and under an obligation to file two returns, • • •

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[18] See, too, *F. E. McGillick Co.*, 30 T.C. 1130, 1150 (1958); *John Danz,* 18 T.C. 454, 465 (1952); and *Automobile Club* v. *Commissioner,* 353 U.S. 180 (1957), where the filing of form 990 information was not sufficient to activate the running of the statute.

> We distinguish *Germantown Trust* from the facts of this case for exactly the same reason. * * *

In the case of a form 1065 partnership return, we need never reach the distinction employed by the Supreme Court in *Lane-Wells* since the indispensable prerequisite for the consideration underlying such distinction—the assumption that the filed return "showed all the facts necessary for respondent to compute taxes" (*Lane-Wells, supra,* quoting from the Circuit Court opinion in that case)—is herein lacking. For absent from a partnership return are such items as the individual partner's itemized deductions, exemptions, payments, credits and elections. Without such information there is no practical way in which individual tax liability can be ascertained or the computation thereof accomplished.[19]

Our opinion in *California Thoroughbred Breeders Association, supra,* in no way conflicts with this rationale. However, even if the *California* case could be read to support the position taken by petitioner, we believe that case is distinguishable since our holding there was based on the specific language of section 6501(g)(2).

Issue 2: Rate of Exchange

In computing cost of goods sold, Duga Illinois converted Argentinian pesos into American dollars at the official exchange rate which prevailed at the time of the respective Argentinian transactions pertinent to this case. Respon-

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[19] We note, too, the following language from *Lane-Wells* which also contributed to the result reached therein:

> Congress has given discretion to the Commissioner to prescribe by regulation forms of returns and has made it the duty of the taxpayer to comply. * * * The purpose is not alone to get tax information in some form but also to get it with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns may be readily accomplished. * * * [321 U.S. 223 (1944).]

dent contests the use of the official exchange rate, and argues that the commercial exchange rate should have been applied. Should we adopt respondent's position, cost of goods sold will have to be adjusted downward, as evidenced by the following table which illustrates the disparity between the two rates of exchange for each of the years shown:

Year	Official Rate of Exchange Pesos to 1 Dollar	Commercial Rate of Exchange Pesos to 1 Dollar
1942	3.36	3.36
1943	3.36	3.36
1944	3.36	3.77
1945	3.36	4.01
1946	3.36	4.07
1947	3.36	4.06
1948	3.36	4.42
1949	3.36	5.47
1950	5.00	9.66

Though our research has failed to uncover any cases which are on all fours with the question before us, many cases have considered the issue of exchange rates in the context of blocked currency. See e.g. *Morris Marks Landau,* 7 T.C. 12 (1946), (valuation of blocked pounds for gift tax purposes); *Estate of Anthony H. G. Fokker,* 10 T.C. 1225 (1948), (valuation of blocked Dutch guilders for estate tax purposes); and *Credit & Investment Corporation,* 47 B.T.A. 673 (1942), (valuation of loss resulting from investment in blocked German marks).

In almost all of these cases the Commissioner asserted deficiencies based upon the official rate of exchange. See *Ceska Cooper,* 15 T.C. 757 (1950); *Estate of Jan Willem Nienhuys,* 17 T.C. 1149 (1952); and *Credit & Investment Corporation, supra.* However, in each instance the courts

were unwilling to accept this argument where it was patently clear that the official rate of exchange did not reflect the exchange rate at which a foreign currency could be traded for U.S. dollars. See *Ceska Cooper, supra,* wherein the Court stated:

> It is our view that the value of the blocked British pound as determined in the free market of the United States should be used as the measure of petitioner's income in each of the taxable years from the salaries and profits which were credited to her account in England. [15 T.C. at 765.]

and *Credit & Investment Corporation, supra,* where the Court framed the issue before it as follows:

> Having concluded that the marks used in the purchase of the securities in 1936 were blocked marks, the question remains whether they had a fair market value. * * * [47 B.T.A. at 681.]

Explicit in many of the blockage cases cited above is the fundamental consideration that United States taxation is "based on the value of property measured in terms of United States dollars." *Estate of Jan Willem Nienhuys, supra,* at 1163. It is similarly evident from a reading of other foreign exchange cases that where gain or loss must be computed, it is the actual cost of the investment in terms of the number of dollars needed (*Willard Helburn, Inc.,* 20 T.C. 740 (1953)) which establishes basis, and the obtainable dollar equivalent of the currency received (*Edmond Weil, Inc.* v. *Commissioner,* 150 F. 2d 950 (C.A. 2, 1945), affirming a Memorandum Opinion of this Court) which determines return. See also *James A. Wheatley,* 8 B.T.A. 1246, 1249 (1927).[20]

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[20] Compare *Eder* v. *Commissioner,* 138 F. 2d 27 (C.A. 2, 1943), where the court remanded the decision of the Board, with instructions to measure the return in terms of economic satisfaction. See, also, Rev. Rul. 64-307, 1964-2 C.B. 163, 166.

The inescapable conclusion we draw from these cases is that taxation of international currency transactions is a pragmatic endeavor. In almost all instances the courts, either in converting the value of property into dollars or in determining the dollar equivalent of gain or loss, have attempted to employ a rule of reason which reflects *actual* dollar worth in terms of salient market conditions. After all, "[t]axation is a practical matter,"[21] and should, therefore, attempt to capture the realities of the situation in question.

We believe that employment of the commercial rate of exchange permits this result since it is the commercial rate which actually determines the number of dollars which reasonable businessmen dealing at arms length will be willing to pay for a commodity at a given time. The validity of this result becomes more apparent when submitted to facts of the case at bar; for, here, Duga Illinois and petitioner realized American dollars as a result of expenditures made in Argentina. To value these expenditures at any rate of exchange other than the one which most accurately reflects the number of dollars which would have been required for the same expenditures (i.e., the commercial rate) would, we believe, result in a distortion of income. Accordingly, we hold that the commercial rate of exchange should have been used in determining cost of goods sold.

Issue 3: Presumptive Correctness of Respondent's Determination

Petitioner next contends that the presumption of correctness which normally attaches to respondent's determination, *Welch* v. *Helvering,* 290 U.S. 111, 115 (1933), must

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[22] *Edmond Weil, Inc.,* a Memorandum Opinion of this Court dated August 9, 1944, in which the Court used the commercial rate of exchange where the "evidence [established] that petitioner was never paid the 'official' rate in exchange transactions."

be negated in this case because of the alleged arbitrary manner in which the respondent denied all of the amounts claimed as cost of goods sold on the information returns filed by Duga Illinois during the years 1954 through 1958. See *Helvering* v. *Taylor,* 293 U.S. 507 (1935). Petitioner's primary assertion is that respondent could not have arrived at a rational cost-of-goods-sold determination under circumstances where respondent's agents were prevented access to the books and records needed for such a determination. Cf. *Herbert Schellenbarg,* 31 T.C. 1269, 1277 (1959). The short answer to this argument is that where the taxpayer has refused to produce books and records requested by respondent's agents, the taxpayer (and not respondent) will be held accountable for any procedural or evidentiary consequences flowing from such a declination. See *Estate of Henry Wilson,* 2 T.C. 1059, 1086 (1943), where the Court used the following language in upholding an estate tax deficiency which was based upon a return constructed by respondent's agent:

> Respondent in making a return is forced by the very nature of things to rely upon the information and testimony given by persons knowing the facts. If they fail or refuse to make a disclosure of pertinent facts respecting the estate, or if they deny the existence of assets includible in the gross estate, respondent can not be charged with arbitrary, capricious, and unreasonable action if after discovery of the existence of such assets, coupled with a continued refusal by the interested parties to make any further disclosure as to assets of the estate, he determines the value of the gross estate from such testimony and information as is available to him and includes therein all assets which may have been jointly held by decedent at death or transferred under circumstances which might bring the property within the estate. Much of what has occurred here is due to petitioners' own acts of omission and commission. If because thereof they find them-

selves in difficulty with the tax authorities, it is a difficulty of their own making and they should not be heard to complain.[22]

We start with two basic propositions: (1) all persons subject to tax or required to file an information return must maintain books and records sufficient to establish all matters shown on a tax return or return of information filed by such persons (section 1.6001-1, Income Tax Regs.);[23] and (2) these books and records are subject to examination by respondent or his agent whenever the liability of any person for any internal revenue tax is at issue. Section 7602.

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[22] See also *Herbert Schellenbarg, supra,* where, after unsuccessful and repeated requests for supporting records, respondent denied in toto unrecorded expenses which were alleged to have been incurred in conjunction with unrecorded sales to which petitioner admitted. In upholding the deficiency determination which flowed from respondent's denial, we stated that where petitioner is unable, through negligence, to produce books and records requested by respondent's denial, we stated that where petitioner is unable, respondent's action, in the absence of such production, will not be deemed arbitrary:

> The great weight of [petitioners'] argument is directed at respondent's failure to offset * * * additional receipts by what [petitioners'] claim were unrecorded expenses * * * [related to] unrecorded sales made by them * * *. Yet, in the face of repeated requests by respondent's agents, no evidence was produced to substantiate these unrecorded transactions. * * * In this posture, we cannot say the respondent's determination was arbitrary and excessive as contended by the petitioners. Thus, its presumptive correctness has not been destroyed * * *.
>
> Though petitioners' inability to offer proof of these unrecorded transactions may work a seeming hardship upon them, it is unquestionably of their own making. * * * [31 T.C. 1277.]

[23] In the case of a partnership, sec. 6031 provides that every partnership must file an annual return of information containing the information specified in that section. The return, when filed, must bear the signature of at least one partner. Sec. 1.6063-1(a), Income Tax Regs.

In the case at bar, respondent's agents were thwarted in their efforts to review books and records relating to income which petitioner may have been liable for as a result of his partnership interest in Duga Illinois. Consequently, respondent's agents were forced to build their case on accountant's work papers and other secondary evidence made availabe to them. As a result, cost of goods sold was denied in toto, and respondent's notice of deficiency held petitioner responsible for his distributive share of the recomputed partnership income for each of the years in question. (See section 702.)

Though we recognize that special agent Mannie of the Intelligence Division was present at all stages of respondent's investigation we do not feel that this fact alone is sufficient to transform petitioner's recalcitrance, notwithstanding that petitioner's attorney may have regarded certain of petitioner's constitutional privileges to be at stake, into a procedural windfall. Indeed, as has been stated in *Boren* v. *Tucker,* 239 F. 2d 767 (C.A. 9, 1956), in every investigation there exists the possibility that information made available to respondent or one of his agents might lead to criminal prosecution:

> In truth, we presume the "Secretary or his delegate" would be unfaithful to his statutory responsibilities if in every examination, once an incorrect return has been demonstrated or established, he did not come to some preliminary conclusion as to whether there existed facts sufficient upon which to base a possible criminal prosecution, without coming to any conclusion as to whether there should be a criminal prosecution. [239 F. 2d 772.]

Accordingly, it seems to us that petitioner's position would be no more compelling if the refusal to produce books and records had been made at a time when special agent Mannie had not yet been assigned to the case. See and compare *United States* v. *Caiello,* 420 F. 2d 471, 472 (C.A. 2, 1969), footnote 2. Were we faced with such a set of circum-

stances, we are confident that petitioner would be denied the procedural parlay which he now seeks. We do not believe that he stands on better footing with the facts of the case now before us.

Moreover, that the records sought may have been immune to process by virtue of the Federal indictment which anteceded the requests made to petitioner's attorney by respondent's agents (see *Internal Revenue Agent* v. *Sullivan*, 287 F. 138 (W.D. N.Y. 1923))[24] does not assist petitioner. The crucial fact is that such records were denied to respondent's agents.[25] Under such circumstances, we cannot say that respondent's determination, which ultimately was based upon the investigation of accountant Grauer's work papers, as well as the other sources of in-

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[24] See also *United States* v. *O'Connor*, 118 F. Supp. 248 (D. Mass. 1953); cf. *Wild* v. *United States*, 362 F. 2d 206 (C.A. 9, 1966); and *Venn* v. *United States*, 400 F. 2d 207 (C.A. 5, 1968), where the production of withheld records was required under sec. 1604(a), notwithstanding the presence of a special agent during the examination and the possibility of subsequent criminal proceedings.

[25] We note that neither petitioner nor his attorney were approached by respondent's agents until after the jeopardy assessment which was levied on October 28, 1964. However, agent Schwartz did contact Marko's attorney prior to the notice of deficiency on December 28, 1964. Moreover, in previously focusing their attention on Stevan, agents Mannie and Schwartz were following the most logical course of action available to them since Stevan had led them to believe that he had possession of the Duga Illinois records and that they could be found at Promak Laboratories.

We also note that, although respondent's agents failed to notify petitioner or his brother that a second inspection of Duga Illinois books for the year 1957 would be required, such failure does not affect the result reached herein since the books sought were not made available to respondent. See *United States Holding Co.*, 44 T.C. 323, 327 (1965); and section 7605(b).

formation, was so insubstantial as to render arbitrary the deficiency determination prepared therefrom.

In arriving at the above result, we have carefully considered the purpose of the presumption of correctness which attaches to respondent's determination and the role which it plays at trial. We note initially that the

> presumption is not evidence in itself and may be rebutted by competent evidence. It operates merely to place upon the opposing party the burden of going forward * * *. * * * [*Compton* v. *United States,* 334 F. 2d 212, 216 (C.A. 4, 1964).]

As such it is merely a fixation of the procedural posture of the parties. Where as here both parties have come forward at trial with a plethora of evidentiary matter, we feel no compulsion to rearrange this procedural alignment. To receive from petitioner the very evidence previously denied to respondent, and to, at the same time, remove from petitioner the burden of going forward would, we think, be contrary to one of the basic considerations underlying the presumption—that the party who is most familiar with the facts in dispute should also be the party upon whom rests the burden of going forward with the evidence.

Issue 5: Cost of Goods Sold

We come now to the question of whether respondent erred in disallowing cost of goods sold to Duga Illinois for each of the years in issue. More specifically, we must decide whether Duga Illinois was entitled to cost-of-goods-sold deductions during these years; and, if so, the amounts which should have been claimed. We view this issue as being primarily factual.

The record of this case exceeds 1,300 pages. In addition, both parties have benefitted us with scores of exhibits and interrogatories. Notwithstanding this mass of evidentiary matter, the picture we have before us of the events which comprise this case is blurred and cracked with age.

In some instances witnesses were called upon to reconstruct with clarity events which occurred more than a quarter of a century ago. The uncertain narrative occasioned by the dimmed memories of these individuals only served to compound with inconsistency a case which would have been difficult to try under the most favorable of circumstances. Nevertheless, we have attempted in our findings of fact to weigh all such inconsistencies, and to arrive at a fair and rational narration of the events which occurred herein. For the most part, therefore, the immediate discussion will merely reappraise these facts in the context of the question presented.

Whether or not a business venture conducted by two or more persons will be regarded as a partnership for tax purposes depends, in large measure, on the intent of the persons involved. *Claire Giannini Hoffman,* 2 T.C. 1160 (1943). The facts in this case indicate that Stevan and Marko were partners for each of the years in question. This partnership, which was formed for the purpose of distributing and selling Krebiozen in the United States, came into being in 1950 shortly after Marko purchased the Krebiozen raw material from Tanoira. Marko's basis in the raw material, for partnership income tax purposes, is derived from the 3,005,000 A$P price paid to Tanoira. [26] See section 722.

The amount paid to Tanoira, while based upon analogous costs (3,005,000 A$P) incurred in the development of Kositerin (as adopted by MPH), also reflected actual cost

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[26] Though we think it reasonable that Marko, at this time, may have intended to make a binding gift to Stevan of one-half of the raw material (which had, in fact, been produced during the term of Stevan's agreement with Tanoira), we cannot assume such an intention from the evidence now before us. Accordingly, for purposes of section 704(d), Marko will be treated as having contributed all of the 2 grams, 35 centigrams of raw material to the partnership.

experience (2,997,500 A$P) as computed by accountant Muchenik. As such, we believe the 3,005,000 A$P figure to be a fair indicator of the raw material cost of the 200,000 ampules of Krebiozen produced in the United States. To this extent, Duga Illinois was justified in taking the cost-of-goods-sold deductions claimed on the partnership returns. However, we believe this amount should have been spread over all of the ampules produced (200,000), as opposed to the number of ampules on hand in 1954 (136,097) when the partnership first solicited payment for the drug. Though we fully appreciate the altruistic, as well as practical, considerations which governed the choice of spreading costs over 136,097 ampules, as opposed to 200,000 ampules, we are constrained to hold that, for the years 1954 through 1958, this method of apportionment did not clearly reflect income.

In addition to the amounts allowed above, the partnership also incurred extensive research expenses as well as extensive expenses related to sterilizing, ampuling and packaging the drug. These amounts (totaling $105,387.38) [27] were recorded in an expense journal main-

[27] Total expenses actually recorded in the journal amounted to $130,713.48. However, of this amount, $20,953.44 was attributable to living costs and was treated by Olga as temporary living expenses while away from home (Argentina). Since petitioner's stay in this country was from the start "indefinite," see *Leo M. Verner*, 39 T.C. 749 (1963), as opposed to "temporary," see *Beatrice H. Albert*, 13 T.E. 129, 131 (1949), we view these expenses as being personal in nature. See and compare secs. 1.871-2(a) and (b), Income Tax Regs. Accordingly, the $130,713.78 shown on Olga's books has been reduced by $20,953.44. Additionally, since $4,372.66 is conceded to have been expended in furtherance of Institute, as opposed to partnership, activities, the $130,713.78 has been further reduced by this amount. Neeted out, these adjustments yield a total expenditure figure of $105,387.38.

tained by Olga and stipulated to by the parties,[28] and are properly allocable between (a) cost of goods sold and (b) research and experimental costs.[29] On our best judgment,

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[28] See footnote 11, *supra*. Stipulation 5 states the following:

> Attached hereto and made a part hereof identified as Exhibit 6 is a copy of an original expense journal prepared by Mrs. Durovic reflecting expenses which were paid from October, 1949 until April, 1954 as identified therein.

[29] See section 174 which, in part, permits a taxpayer to treat research and experimental costs, paid or incurred in a taxable year subsequent to December 31, 1953, as noncapital expenditures. Since, as petitioner states on brief, "substantially all the costs in question were incurred prior to the effective date [of section 174] of the Internal Revenue Code of 1954," the tax treatment of such costs is governed by the case law pertinent to pre-1954 Code years. The rules developed by these cases are summarized in the following language from *John F. Koons*, 35 T.C. 1092, 1099 (1961):

> Prior to the enactment of the Code of 1954 there was no statutory provision dealing with the tax treatment to be accorded research and experimental expenditures, and the taxpayer had no option to treat such costs as deductible expenses. To the extent that they were ordinary and necessary business expenses they were deductible; to the extent that they were capital they could be capitalized and were recoverable through depreciation or amortization where the useful life was determinable. *Gilliam Manufacturing Co.*, 1 B.T.A. 967 (1925); *Haseltine Corporation*, 32 B.T.A. 110 (1935), affirmed on this issue 89 F. 2d 513 (C.A. 3, 1937); *Claude Neon Lights, Inc.*, 35 B.T.A. 424 (1937); *Hart-Bartlett-Sturtevant Grain Co.*, 12 T.C. 760 (1949), affd. 182 F. 2d 153 (C.A. 8, 1950); *Red Star Yeast & Products Co.*, 25 T.C. 321, 341, 343 (1955). In the event, however, that they were not ordinary and necessary expenses and a period of useful life could not be definitely ascertained, the amortization of such expenditures was not allowable. * * *

(See also Jack R. Miller, "Research and Development Costs," 7th Ann. N.Y.U. Tax Inst. 134 (1949).)

In the case at bar, we think it is clear that the expenditures for

we hold that, of these amounts, one-half ($52,693.69) was properly allocable to costs of goods sold. *Cohan* v. *Commissioner*, 39 F. 2d 540 (C.A. 2, 1930).

Summarizing our findings, we arrive at the following cost-of-goods-sold computation for each of the years in question:

Allocable costs:		
(1) 3,005,000 A$P converted to U. S. dollars at (9.66 A$P to $1) commercial rate of exchange stipulated to be in force during 1950	$311,076.60	
(2) U.S. expenditures	52,693.69	$363,770.29
Number of Ampules	200,000	
Divided into total allocable costs =	$363,770.29	
Per ampule cost	1.82	

(Footnote continued)

research and experimentation were calculated to perfect and improve Krebiozen so that it might be licensed for sale on a nonexperimental basis, and to establish its efficacy to the medical world. We think such expenditures were capital in nature; and, since the benefits to be obtained from such research were neither limited to the ampules already produced, nor susceptible to measurement in terms of useful life, we reluctantly see no way in which to allow amortization of such expenditures for the years in question. See *Hart-Bartlett-Sturtevant G. Co.* v. *Commissioner*, 182 F. 2d 153 (C.A. 8, 1950) affirming 12 T.C. 760 (1949).

The tax treatment to be accorded these expenditures in the year in which the experiments were abandoned and the partnership dissolved is beyond the pale of this discussion since we do not have before us the year (1959) in which such dissolution occurred. Cf. *Hart-Bartlett-Sturtevant G. Co.* v. *Commissioner, supra.*

	Number of Ampules distributed	X	$1.82 =	Cost of Goods Sold
1954	17,752	X	$1.82	$32,308.64
1955	30,674	X	1.82	55,826.68
1956	23,733	X	1.82	43,194.06
1957	33,722	X	1.82	61,374.04
1958	24,381	X	1.82	44,373.42

In arriving at the above conclusion we have rejected petitioner's assertion that Argentinian costs incurred by petitioner and attributable to the development and manufacture of Kositerin should also be considered in computing the basis of the Krebiozen raw material to petitioner and the partnership. See section 723. Though the preparation and extraction processes used to produce Kositerin and Krebiozen were identical, and though Kositerin was a direct, though fortuitous, outgrowth of Stevan's early work in the field of cancer, the two drugs—like the stimulants used to produce them—were dealt with separately and financed independently. Even though the brothers may at one time have considered distributing Kositerin through a United States partnership, we think it clear that this idea was jettisoned as a result of the unencouraging findings made by Northwestern University. Accordingly, since the Kositerin ampules were never used in or contributed to the activites of Duga Illinois, petitioner's argument must be rejected.

Notwithstanding the above, we do find that after January 21, 1950, the Kositerin ampules were a capital asset in Marko's hands, the uninsured destruction of which gave rise to a section 1231[30] loss in 1956, the year in which

[30] SEC. 1231. PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS.

(a) General Rule. * * * For purposes of this subsection—

(1) in determining under this subsection whether gains exced losses, the gains described therein shall be included only

spoilage occurred. As we view the January 1950 transaction between Marko and the Duga S.A. investors, Marko received substantially all ownership rights[31] to and possession of the Kositerin ampules subject to any contractual royalties which may have been reserved to Stevan. The ampules were thereafter placed in storage under the supervision of Galmarini. We think the 1953 application to MCI for an increased cost basis, Galmarini's continued supervision and the special trip Marko made to Argentina in 1956 to witness the destruction of the ampules all evidence the fact that Marko held the ampules for the production of income until the time they were actually destroyed. Accordingly, we cannot agree with respondent that any loss

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(Footnote continued)

if and to the extent taken into account in computing gross income and the losses described therein shall be included only if and to the extent taken into account in computing taxable income, except that section 1211 shall not apply; and

(2) losses (including losses not compensated for by insurance or otherwise) upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of (A) property used in the trade or business or (B) capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

Since the loss in question occurred in 1956, the uninsured loss provisions contained in the final sentence of section 1231(a) (not shown above) do not apply to the facts of this case. See section 1.1231-1 (e) (2), Income Tax Regs.

[31] The agreement between Marko and the Duga S.A. investors indicates that Olga retained a proportional interest in the Kositerin ampules equivalent to her 1,000 A$P investment.

attributable to the Kositerin ampules occurred during an earlier year.[32]

The practical result of our findings (with regard to Kositerin) is that Marko incurred an ordinary loss in 1956 which we value at 792,600 A$P ($113,357)—the aggregate of Marko's 255,100 A$P ($57,715) investment in 1948 and the 537,500 A$P ($55,642) outlay in 1950. (Though deductible as a section 1231 loss in 1956, this amount will not be subject to the two-year carryback nor the five-year carryforward provisions of section 172, as provided by section 1.172-4(a)(1)(vi), Income Tax Regs., since the loss was not attributable to a trade or business. Section 172(d)(4). See *Garrigo* v. *United States*, 296 F. Supp. 1110, 1114 (N.D. Tex., 1968); and *Mae E. Townend*, 27 T.C. 99 (1956). No may we consider the language of section 172(d)(4)(C) (which excludes casualty losses from the trade or business requirement of section 172(d)(4)) since petitioner has failed to introduce any evidence tending to establish that the spoilage was sudden and not the result of a "progressive deterioration [of the ampules] through a steadily operating cause." *Fay* v. *Helvering*, 120 F. 2d 253 (C.A. 2, 1941); *Ray Durden*, 3 T.C. 1 (1944).)

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[32] We also reject respondent's assertion that the facts underlying Marko's investment in Kositerin (as well as the transaction with Tanoira in which the Krebiozen raw material was obtained) were not sufficiently pleaded to apprise respondent of the nature of petitioner's case. Though, with regard to these transactions, the pleadings filed by petitioner may have lacked specificity, our observation of the parties during the trial of this case, as well as our examination of the numerous interrogatories and motions filed before trial, lead us to believe that respondent was in no way surprised or prejudiced by the testimony and other evidence elicited during the trial in support of these transactions. Since pleadings are but procedural tools which may, in any event, be amended to conform to the evidence adduced, we see no basis, in the absence of surprise or prejudice, for sharing the view of this matter taken by respondent. See *Commissioner* v. *Finley*, 265 F. 2d 885, 888 (C.A. 10, 1959), affirming a Memorandum Opinion of this Court and cases therein cited.

Since we are without proof as to whether Galmarini complied with the January 8, 1954, MCI cost directive in which MCI requested evidence in substantiation of the post-1949 storage and administrative costs claimed by Galmarini in his November 1953 petition, we are unable to augment our 792,600 A$P valuation by the amount of these alleged, but unsupported, costs. Additionally, we find no basis for adding to this valuation the 500,000 pesos which were paid by Marko to the Martinis in 1949. Though part of the whirlwind of events in this case, this payment merely represented the gratuitous satisfaction of obligations incurred by Stevan during his early South American research. Cf. *Fromm Laboratories, Inc.*, v. *Commissioner*, 295 F. 2d 726 (1961), affirming a Memorandum Opinion of this Court.

Issue 5: Additions to Tax for Fraud

We now address ourselves to the question of whether respondent erred in determining that petitioner was fraudulent in failing to pay tax for each of the years in issue.

The existence of fraud is a question of fact. "Fraud" means actual, intentional wrongdoing, i.e., the intent to evade a tax believed to be owing, *Mitchell* v. *Commissioner*, 118 F. 2d 308 (C.A. 5, 1941); and, as is wont with fraud cases generally, evidence of fraud must be ascertained from the surrounding facts. *William C. deMille Products, Inc.*, 30 B.T.A. 826 (1934); *M. Rea Gano*, 19 B.T.A. 518 (1930).

To support a determination of fraud for any of the years in question respondent has the burden of proving fraud by "clear and convincing" evidence. *Carter* v. *Campbell*, 264 F. 2d 930 (C.A. 5, 1959); *Jacob D. Farber*, 43 T.C. 407, 419 (1965), reaffirmed in a supplemental opinion 44 T.C. 408 (1965). This, we believe, respondent has failed to do.

It has already been established that petitioner failed to file returns for each of the years in point. Though, as respondent points out, such failure does give rise to an

inference of fraud, *Nathan Bilsky*, 31 T.C. 35 (1958), it is not alone sufficient to meet the clear and convincing evidence test. *John Marinzulich*, 31 T.C. 487, 490 (1958). *Anderson* v. *Commissioner*, 250 F. 2d 242, 243 (C.A. 5, 1957). Moreover, in the instant proceeding, we do not think it proper to attach an inference of fraud to petitioner's failure to file. Instead we see a pattern of good faith reliance on petitioner's legal and tax advisors, who saw no necessity for filing in view of the large partnership losses which they determined. Granted, much of the information placed at their disposal related to transactions which took place in Argentina. However, we are convinced (and the various documents introduced into evidence support our conviction) that the disclosures made to petitioner's advisors fairly and honestly reflected petitioner's out-of-pocket, economic experience while in South America. Cf. *Merritt* v. *Commissioner*, 301 F. 2d 484, 487 (C.A. 5. 1962). That the tax treatment accorded these expenditures by petitioner's advisors did not comport with what was required is surely not evidence of fraud on the part of petitioner.

The loss, in 1956, of certain records which respondent regards as being central to petitioner's case has been adequately and credibly explained by petitioner and corroborated by the interrogatories of two witnesses. Under such circumstances, even if we were to agree with respondent as to the essential character of these records, we would not feel justified in attaching any adverse importance to their loss. Cf. *Lillian Kilpatrick*, 22 T.C. 446 (1954), affd. 227 F. 2d 240 (C.A. 5, 1955).

The withdrawal in 1951 of Ivy's requests for revenue rulings adds little to respondent's argument. The ruling requests were made at a time when petitioner and his brother were more preoccupied with establishing a center, the Institute, for the treatment of cancer, than with estab-

lishing their tax status. Moreover, the duration of their stay in this country was, at best, uncertain. As stated in the documentation referred to extensively in our findings of fact, any effort to leave the country in quest of the Argentinian cost records requested by respondent, could very well have subjected the brothers and, therefore, the Institute to considerable difficulty. Their reluctance to chance this possibility was, in our estimation, reasonable.

Finally, we are told by respondent that petitioner's failure to call Stevan as a witness raises an inference of fraud, *Steiner* v. *Commissioner,* 350 F. 2d 217 (C.A. 7, 1965). Though we acknowledge that the unexplained failure to call a witness, whose testimony might reasonably be expected to favor the taxpayer, does raise an adverse inference, it is questionable whether, in this case, Stevan's testimony could have shaken loose any evidentiary stones not already overturned. In any event, our very careful consideration of the entire record of this case, *Frank Imburgia,* 22 T.C. 1002, 1014 (1954), leads us to the firm conclusion that at no time during any of the years in question did petitioner intend to defraud the Government by failing to pay tax. Marko, though sometimes excitable, was at all times a credible witness. Most of the transactions and occurrences of which he spoke, and which respondent now contests, were amply supported by extensive documentation. In all, the transcript, the interrogatories and the exhibits reveal hardly a clue of fraud. Accordingly, we hold that respondent erred in determining additions to tax under section 6653(b).

Issue 6: Additions to tax for failure to file timely declaration of estimated tax (1954) and for underpayment of estimated tax (1955 through 1958).

A. 1954

Section 294(d)(1)(A) of the Internal Revenue Code of 1939, which applies to all years beginning before January 1, 1955 (section 6654(h)), provides, in part, as follows:

> (A) Failure to file declaration.—In the case of a failure to make and file a declaration of estimated tax within the time prescribed, unless such failure is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect, there shall be added to the tax 5 per centum of each installment due but unpaid, and in addition, with respect to each such installment due but unpaid, 1 per centum of the unpaid amount thereof for each month (except the first) or fraction thereof during which such amount remains unpaid. * * *

Since there is no evidence that petitioner filed a declaration of estimated tax at any time during 1954, the only question raised by section 294(d)(1)(A) is whether petitioner's failure to file was due to reasonable cause. We think such reasonable cause did, in fact, exist.

Where a taxpayer exercises ordinary business care and prudence, his failure to file a declaration of estimated tax, pursuant to section 294(d)(1)(A), within the prescribed time will not be deemed negligent. *George S. Van Schaick, Supt. of Insurance,* 32 B.T.A. 736, 744 (1935). When warranted, reliance on a certified public accountant or an attorney will constitute ordinary care and prudence. *Estate of H. B. Hundley,* 52 T.C. 495, 514 (1969). In the instant case petitioner relied on the tax expertise of accountant Grauer. Since to our knowledge petitioner had not prior to 1954 had occasion to file returns for United States income, petitioner's reliance upon Grauer was both reasonable and prudent. Cf. *Estate of Henry P. Lammerts,* 54 T.C. —— (March 10, 1970). The mere fact that, according to the conclusions reached by us in this proceeding, Grauer was incorrect in concluding that petitioner would not have to pay tax in 1954, and that a declaration of estimated tax would, therefore, not be required, is not fatal to petitioner. *Brooklyn & Richmond Ferry Co.,* 9 T.C. 865, 877 (1947). Petitioner's good faith disclosure to his accountant, who was in all respects well qualified, and who

was aware of petitioner's reliance, was, in our judgment, all that was required. Compare *Rene R. Bouche*, 18 T.C. 144, 149 (1952) (reliance not sufficient where accountant not competent).

B. 1955-1958

The additions to tax, as determined by respondent, for underpayment of estimated taxes during the years 1955 through 1958 is governed by section 6654.[33] As we said in *Estate of Berney Ruben*, 33 T.C. 1071, 1072 (1960), "This section has no provision relating to reasonable cause and lack of willful neglect. It is mandatory and extenuating circumstances are irrelevant." Only if petitioner shows that his case comes within one of the exceptions provided in subsection (d) can he be excused from payment of a penalty under section 6654. *John P. Reaver*, 42 T.C. 72 (1964). This he has not shown and (to the extent now applicable) respondent's determination may not, therefore, be overturned.

Issue 7: Denial of Election to File Joint Returns

On March 10, 1965, petitioner and his wife filed joint returns on form 1040 for each of the years 1954 through 1958. The final question for our consideration is whether the election to file a joint return was proper in light of respondent's antecedent statutory notice in which individual rates were employed in determining petitioner's deficiency.

Though several cases have touched upon this issue and

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[33] SEC. 6654. FAILURE BY INDIVIDUAL TO PAY ESTIMATED INCOME TAX.

(a) Addition to the Tax.—In the case of any underpayment of estimated tax by an individual, except as provided in subsection (d), there shall be added to the tax under chapter 1 for the taxable year an amount determined at the rate of 6 percent per annum upon the amount of the underpayment (determined under subsection (b)) for the period of the underpayment (determined under subsection (c)).

have held for respondent,[34] the specific question presented has not been considered by this Court with regard to tax years covered by section 6013(b),[35] or its progenitor, section 51(g) of the Internal Revenue Code of 1939 (applicable to years beginning after December 31, 1950).

Section 6013(b),[36] as originally contained in the Reve-

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[34] See *Max Dritz*, T.C. Memo. 1969-175, presently on appeal, (joint rates not available where putative election made in pleadings, no returns having been filed); *Joseph A. Mundy*, T.C. Memo. 1955-270 (assertion of individual rates by respondent upheld where no returns filed).

[35] In *Est. of Samuel Grobart*, T.C. Memo. 1961-128 (considered extensively by both parties), a case dealing with two pre-1951 years, we held that petitioner and his wife were not entitled to elect joint rates for the years 1948 and 1949 since their returns for these years had been filed subsequent to respondent's notice of deficiency in 1957, in which individual rates had been used to compute tax.

[36] SEC. 6013. JOINT RETURNS OF INCOME TAX BY HUSBAND AND WIFE.

* * *

(b) Joint Return After Filing Separate Return.—

(1) In general.—Except as provided in paragraph (2), if an individual has filed a separate return for a taxable year for which a joint return could have been made by him and his spouse under subsection (a) and the time prescribed by law for filing the return for such taxable year has expired, such individual and his spouse may nevertheless make a joint return for such taxable year. A joint return filed by the husband and wife under this subsection shall constitute the return of the husband and wife for such taxable year, and all payments, credits, refunds, or other repayments made or allowed with respect to the separate return of either spouse for such taxable year shall be taken into account in determining the extent to which the tax based upon the joint return has been paid.

* * *

(2) Limitations for making of election.—The election provided for in paragraph (1) may not be made—

* * *

(B) after the expiration of 3 years from the last date prescribed by law for filing the return for such taxable year (determined without regard to any extension of time granted to either spouse).

nue Act of 1951, was enacted to remedy the dilemma which often befell married taxpayers who were required to make a binding election (regarding the type of return they would file) at a time when they lacked "informed tax knowledge not possessed by the average person." S. Rept. No. 781, 82d Cong., 1st Sess. (1951), 1951-2 C.B. 458, 492. Accordingly, with certain exceptions, section 6013(b) and its Revenue Act of 1951 analogue permit married persons, who originally elect to file individual returns, to later change their election and file joint returns at any time within the three-year period of the statute of limitations.

In the instant case, petitioner and his wife did not file joint returns for the years 1954 through 1958 until March 10, 1965. Clearly, therefore, had they originally filed individual returns for these years, their election in 1965 to file joint returns would have been untimely. We see no reason why the same rules should not obtain where, as here, no returns were originally filed. However, we need not premise our decision on this fact alone since, in our estimation, the administrative considerations which accompany a system such as ours, where taxation is based upon voluntary disclosure, demand that where, "as the result of a failure to file a return, the Commissioner has been required to make an election for the taxpayers * * * that election may not thereafter be altered." *Spanos* v. *United States,* 212 F. Supp. 861, 864 (D. Md. 1963), reversed in part by 323 F. 2d 108 (C.A. 4, 1963), but affirmed as to matters relevant to the language quoted. See also cases discussed therein. Accordingly, we believe this issue must be decided in favor of respondent.

DECISION WILL BE ENTERED UNDER RULE 50.